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Petition and Transcript of Record

Supreme Court of the United States

OCTOBER TERM, 1932

No. 322

THE MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY, PETITIONER,

vs.

THE UNITED STATES

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

PETITION FOR CERTIORARI FILED AUGUST 26, 1932

CERTIORARI GRANTED NOVEMBER 7, 1932

(37,019)

(37,019)

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SUPREME COURT OF THE UNITED STATES

October Term, 1932

No. 322

The Massachusetts Mutual Life Insurance Company (a Corporation), Petitioner,

v.

The United States

Petition for Writ of Certiorari to the Court of Claims

May it please the Court:

A

Summary Statement of the Matter Involved

The petitioner, a Massachusetts corporation, during the year 1926, and for many years prior thereto, was engaged in the business of making and selling life insurance on the mutual level premium plan in Massachusetts and other states of the United States, and as such was subject to the Revenue Act of 1926 providing for the payment of income taxes for said year. (R. p. 8, Finding 1.)

The policy contracts issued by the petitioner provide that such policy will participate annually in the distribution of the surplus funds of the company; that such dividends, at the option of the insured, among other things, will be paid in cash or may be left with the company to accumulate, subject to withdrawal on demand; and that dividends left [fol. 2] to accumulate will be credited at the end of each policy year with interest at such rate, not less than three per cent, as may be determined by the directors, which interest is subject to withdrawal on demand. (R. p. 10, Finding 8.)

During the year 1926, the period involved in this case, each policyholder leaving dividends with the petitioner to accumulate was given credit in his individual account with the petitioner for his respective part of the interest which accrued thereon during said year and a regular form

notice of the amount so credited was mailed to each such policyholder prior to the close of the year. Such interest was payable on demand and the policyholder was so advised. It was the practice of the petitioner to accept such notice on demand for cash payment of the amount shown therein. (R. p. 8, Finding 1.)

Article 685 of Treasury Regulations 69, pertaining to the Revenue Act of 1926, provides:

"(3) The deduction allowed by section 245 (a) (8) for interest on indebtedness is the same as that allowed other corporations by section 234 (a) (2) (see articles 561 and 121), but this deduction includes item 18 of the disbursement page of the annual statement of life companies to the extent that interest on dividends held on deposit and surrendered during the taxable year is included therein. Dividends left with the company to accumulate at interest are a debt and not a reserve liability."

The special provisions of the 1926 Revenue Act relating solely to life insurance companies, by Sections 244 and 245, provide that gross income shall consist of interest, dividends and rents received during the taxable year, and for the deduction therefrom, including certain items not involving payment, of interest received which is exempt from taxation, dividends received from certain corporations, in- [fol. 3] vestment expenses paid, certain taxes and other expenses paid, during the taxable year. Subdivision (8) of Section 245 (a) provides for the deduction of "All interest paid or accrued within the taxable year on its indebtedness * * *." (44 Stat. L. 47, 48.)

In the determination of petitioner's income tax liability for the year 1926 and the adjudication of its refund claims for said year, the Commissioner of Internal Revenue refused to allow petitioner to deduct from gross income the sum of $544,964.40, which was the amount of interest accrued and credited to its policyholders during said year but not actually withdrawn by them on dividends left with it to accumulate, and which petitioner had deducted in its tax return for said year. Instead thereof, said Commissioner allowed petitioner a deduction of $248,405.97, which was the amount of interest on dividend accumulations actually withdrawn or surrendered by its policyholders during said year, irrespective of the year of origin, and

which petitioner had not taken as a deduction in its tax return. The major portion of this item originated in prior years. (R. pp. 8, 9; Findings 1, 4, 5, 7.)

Petitioner claims it is entitled to recover the tax paid, with interest thereon as provided by law, on the difference between said amount claimed in its tax return and the amount allowed by said Commissioner on a different basis, as a deduction, said difference representing the amount of interest accrued and credited to its policyholders for said year which it has not received as a deduction and which has substantially increased petitioner's income tax liability for said year. After said Commissioner had rejected petitioner's refund claim on account of said increase in [fol. 4] income taxes paid by it for said year, petitioner brought this suit in the Court of Claims, which, on May 31, 1932, decided that petitioner was not entitled to recover and dismissed its petition.

The Question Presented

The sole question here presented is whether interest accrued and credited to petitioner's policyholders during the year 1926 on dividends left with petitioner to accumulate, and unqualifiedly subject to withdrawal on demand, but not actually withdrawn during said year, is deductible from gross income in the computation of net income under the provisions of Section 245 of the Revenue Act of 1926. (44 Stat. L. 47, 48.)

B

Reasons Relied on for the Allowance of the Writ

1. The question here involved is of great public interest and importance, as it very materially affects the revenues of the Government.

2. The question here involved is of great public importance, because it relates to the proper determination of the net income of life insurance companies, which were, during the year involved in this case, and still are, subject to taxation under the Federal Revenue Laws.

3. The question here involved is of great and continuing public importance, because it relates to the proper construction of Section 245, and especially to subdivision (a)

(8) thereof, of the Revenue Act of 1926 which provides for the deduction from gross income, in the case of life insurance companies, of "All interest paid or accrued within the taxable year on its indebtedness * * *." This pro- [fol. 5] vision is the same in all the Federal Revenue Acts since and including the Revenue Act of 1921 to and including the Revenue Act of 1932, and a determination of the question here involved will settle that question under all said Revenue Acts.

4. This case involves a new question arising under the Federal Revenue Acts which has never been decided by any other court and for this reason the decision below should be reviewed.

5. The decision below should be reviewed because it involves an important question of Federal income tax law which has not been, but should be, settled by this Court.

6. The Regulations of the Bureau of Internal Revenue provide, in the case of life insurance companies, that only interest actually withdrawn or surrendered during the year may be deducted from gross income in computing net income, which seems to be in conflict with the provisions of the Revenue Act of 1926.

7. The Court of Appeals of the District of Columbia, in Hadley vs. Commissioner of Internal Revenue (36 Fed. (2d) 543) held that profits credited to stockholders of a corporation and unqualifiedly subject to their demand are constructively received when so credited and constitute taxable income to such stockholders for the year such credit is made, regardless of whether the tax return is made on a cash or accrued basis. The Circuit Court of Appeals for the Sixth Circuit, in Commissioner of Internal Revenue vs. Bingham (35 Fed. (2d) 503) held that dividends actually received in 1923 by a stockholder whose books are kept on a cash receipts and disbursements basis are nevertheless required to be included in gross income in 1922 when they [fol. 6] were declared and unqualifiedly subject to his demand. The same principle is affirmed by the Circuit Court of Appeals for the Eighth Circuit, in Charleston & Western Carolina Railroad Company vs. Burnett (No. 5074, decided May 5, 1931; not yet reported), and by the Circuit Court of Appeals for the Seventh Circuit in Chicago, Rock Island

& Pacific Railroad Company vs. Commissioner (47 Fed. (2d) 990). These decisions seem to be in conflict with the opinion of the Court below in that the Court below, upon an important question of general law, failed to recognize and apply the distinction between an accrual in the usual case and an accrual under conditions equivalent to receipt or payment, in its construction of the Federal Revenue Act here involved.

Wherefore, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the Court of Claims, commanding that Court to certify and to send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings, but omitting the evidence, in the case numbered and entitled on its Docket No. K-323, The Massachusetts Mutual Life Insurance Company (A Corporation) vs. The United States, and that the said judgment of the Court of Claims may be reversed by this Honorable Court and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

The Massachusetts Mutual Life Insurance Company, by A. R. Serven, Guy Patten, Counsel for Petitioner.

[fols. a & 1] COURT OF CLAIMS OF THE UNITED STATES

No. K-323

THE MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY, a Corporation,

vs.

THE UNITED STATES

I. HISTORY OF PROCEEDINGS

On July 22, 1929, the plaintiff filed its original petition.

On August 31, 1929, the defendant filed a general traverse to said petition.

On January 18, 1930, by leave of court, the plaintiff filed its amended petition.

Said amended petition is as follows:

II. Amended Petition—Filed January 18, 1930

To the Honorable the Court of Claims:

The plaintiff in the above-entitled cause respectfully represents to the Court:

I

Plaintiff is a corporation, duly organized and existing under the laws of the Commonwealth of Massachusetts, having its principal office at Springfield, in said Commonwealth, and is now and has been continously engaged for many years in the business of making and selling various forms of life insurance on the mutual level premium plan in Massachusetts and other States of the United States.

II

Plaintiff has continuously complied with all the laws of the various States in which it transacts business and with [fol. 2] the rules and regulations of the respective State insurance departments thereof, prescribing the conditions upon which it was allowed to transact its said business within said States prior to and during the year 1926 and thereafter.

III

Plaintiff, because of its transacting the business of insurance within the United States during the year 1926, became and was subject to the provisions of the Revenue Act of 1926, approved February 26, 1926 (44 Stat. L. 9) and did, in the year 1927, duly file its income tax return for the year 1926 under said Revenue Act, and the regulations of the Treasury Department then in effect, and computed its net taxable income and the tax liability thereon as so required.

IV

Thereafter, the Commissioner of Internal Revenue assessed an income tax against plaintiff for the year 1926 in the amount of $208,852.37, which plaintiff paid during the

year 1927, as follows: $52,213.09 on March 14; $52,213.09 on June 13; $52,213.09 on September 12, and $52,213.10 on December 13.

V

Thereafter, the said Commissioner demanded an additional income tax for said year in the amount of $63,776.94, which plaintiff paid under protest on March 26, 1928, together with interest thereon of $3,539.18.

VI

On or about February 27, 1928, plaintiff filed its refunding claim with the said Commissioner for the refund of $160,-[fol. 3] 878.09, or such greater amount as was legally refundable, of the tax paid by it for said year, on the ground, among others, that it was entitled to the additional deduction from gross income of $544,964.40, being the amount of interest accrued and paid during said year on dividends left by policyholders with the company to accumulate at interest and accumulations thereon, said policyholders having been given credit and notice thereof for said amount in their respective individual accounts with the company, pursuant to the terms of their policy contracts, and all of which interest so credited was subject to their demand.

VII

On July 13, 1928, plaintiff received an undated overassessment certificate and attached statements from the Commissioner of Internal Revenue, based in part upon the adjudication of plaintiff's said refunding claim, which contained, among other things, the following language:

"Your contention that you are entitled to deduct interest on dividends left with the company, $544,964.40, shown on Line 22, Page 5, of annual report, cannot be conceded from the evidence submitted. The interest deduction is limited to the amount shown on Line 18, Page 3, of your annual report."

Line 18, Page 3, of plaintiff's annual statement for 1926, shows the amount of interest paid on dividends left with the company to accumulate at interest and accumulations thereon which were surrendered during the year.

VIII

In view of the language above quoted in connection with the adjudication of said refunding claim, plaintiff on or about October 4, 1928, filed an additional claim with said Commissioner for the refund of $68,120.55, or such greater amount as was legally refundable for said year, solely on [fol. 4] the ground that it was entitled to the additional deduction from gross income of $544,964.40, on account of interest accrued and paid during said year on dividends left by policyholders with the company to accumulate at interest and accumulations thereon, said policyholders having been given credit and notice thereof for said amount in their respective individual accounts with the company, pursuant to the terms of their policy contracts, and all of which interest so credited was subject to their demand. Plaintiff has not been advised of any adjudication of this refunding claim by said Commissioner, nor has it been advised of any credit or refund on account of said claim.

IX

Under Section 245 (a) (8) of the 1926 Revenue Act, plaintiff was entitled to deduct from its gross income in computing its income tax liability for the year 1926—

"All interest paid or accrued within the taxable year on its indebtedness * * *."

X

The Commissioner of Internal Revenue failed and refused to include in his computation of the deductions to which plaintiff was entitled under said Section 245 (a) (8) the item of $544,964.40, on account of interest accrued and paid by credits to policyholders in their respective individual accounts with the company during the year 1926, on dividends left with the company to accumulate at interest and accumulations thereon, pursuant to the terms of their policy contracts, and thereby deprived plaintiff of the benefit of this deduction for said year. This failure and refusal of said Commissioner to deduct the said $544,964.40 from plaintiff's gross income in the computation of its income tax liability illegally and erroneously increased the amount

of tax paid by plaintiff for said year 1926 by $68,120.55, [fol. 5] which plaintiff now asks be refunded to it, together with the $3,539.18 which the said Commissioner required plaintiff to pay as accrued interest on its additional tax of $63,776.94, as stated in Section V hereof.

XI

Plaintiff further avers that it is and has been the owner of the claim hereinbefore set forth continuously from its inception and has never sold or assigned the same or any part thereof or interest therein; that plaintiff is justly entitled to the amounts herein claimed from the United States, after allowing all just credits and offsets; that plaintiff is a citizen of the United States, and has at all times borne true allegiance to the Government of the United States and has not in any way voluntarily aided, abetted, or given encouragement to rebellion against the said Government, or aided or abetted or given encouragement to its enemies, and plaintiff believes that the facts stated herein are true.

XII

Plaintiff therefore prays judgment against the defendant for the sum of $71,659.73, with interest thereon, as provided by law.

A. R. Serven, Attorney for Plaintiff.

Duly sworn to by A. R. Serven. Jurat omitted in printing.

[fol. 6] III. General Traverse—Filed Feb. 27, 1930

And now comes the Attorney General, on behalf of the United States, and answering the amended petition of the plaintiff herein, denies each and every allegation therein contained; and asks judgment that the amended petition be dismissed.

Charles P. Sisson, Assistant Attorney General.
C. F. K.

IV. Argument and Submission of Case

On February 10, 1932, this case was argued and submitted on merits by Mr. Guy Patten, for the plaintiff, and by Mr. Assistant Attorney General Charles B. Rugg, for defendant.

[fol. 7] V. **Special Findings of Fact, Conclusion of Law, and Opinion of the Court by Littleton, J.**—Filed May 31, 1932

Mr. Guy Patten for the plaintiff.

Mr. A. R. Serven and Mr. John W. Smith were on the brief.

Mr. Assistant Attorney General Charles B. Rugg for the defendant.

Mr. Lisle A. Smith and Mr. Edward H. Horton were on the brief.

This suit was instituted to recover $71,659.73, with interest, income tax alleged to have been illegally collected for 1926, on the ground that the defendant erroneously refused to allow plaintiff a deduction under section 245 (a) (8) of the revenue act of 1926 of $544,964.40, interest accrued and credited to its policyholders on dividends declared and credited to said policyholders and left with the company at interest. The interest in question was duly credited to the policyholders during 1926 and was subject to their demand during that year.

The defendant held that the plaintiff, being a life insurance company and therefore required to compute its income and deductions on the basis of actual receipts and disbursements, was entitled to deduct, in 1926, only $248,405,97, representing the interest on dividends and accumulation thereon credited and set apart to the policyholders during 1926 and prior years, and actually withdrawn by the policyholders or surrendered to the plaintiff to be applied in reduction of premiums or used to purchase participating paid-up additions to the policies. Inasmuch as the commissioner allowed a deduction for 1926 of $248,405.97 on account of interest actually withdrawn or surrendered in 1926, the plaintiff sets forth in its brief that while the basis on which this amount was allowed as a deduction was

different from the basis on which it claims that interest on $544,964.40 was constructively paid during 1926, the amount for which judgment should be entered should be determined by deducting from gross income for 1926 the amount of $296,558.43 in excess of that allowed by the commissioner, the last-mentioned amount being the difference between the total interest credited and set apart to the policyholders during 1926 and claimed as a deduction, and the amount allowed as a deduction by the commissioner. On this basis the overpayment for 1926 would be $39,126,92, for which the plaintiff asks judgment with interest.

[fol. 8] SPECIAL FINDINGS OF FACT

1. Plaintiff, a Massachusetts corporation with principal office and place of business at Springfield, is now, and, for many years past, has been engaged in the business of making and selling various forms of life insurance on the mutual level premium plan in Massachusetts and other States of the United States.

It filed its income tax return for 1926 on Form 1120-L, designated "Life Insurance Income Tax Return," showing a tax of $208,852.37, which was paid in four installments of $52,213.09 each on March 14, June 13, and September 12, 1927, and $52,213.10 on December 13, 1927. In this return plaintiff deducted from its gross income $544,-964.40 as interest paid during 1926, which amount represented the aggregate amount of interest due policyholders on dividends and accumulated interest thereon left by them with the plaintiff to accumulate at interest and was accrued and credited to the policyholders to whom credited during the year 1926, but not actually withdrawn or surrendered by them during the year. Credit was given to each policyholder during the year in his individual account for his respective part of such interest, and a regular form notice of the amount so credited was mailed to each such policyholder prior to the close of 1926. This notice showed the amount of dividends credited, the accumulations thereon under each policy contract, and the amount of interest due and credited thereon during 1926. Interest was payable on demand to the policyholders to whom such notice was given, and the policyholder was so advised. It was the practice of the plaintiff company to accept such

notice on demand for cash payment of the amount shown therein.

2. April 9, 1921, the Treasury Department ruled that life-insurance companies were required to make their returns on the basis of actual receipts and disbursements as distinguished from an accrual basis, and such regulation was published in "Bulletin 'H,' Income Tax Rulings Peculiar to Life Insurance Companies." It provided:

"Basis of Returns.—Returns of life-insurance companies shall be made on a receipts and disbursements basis, as distinguished from an accrual basis, as being in accordance with the method of accounting regularly employed by such companies. Any life-insurance company having life and casualty departments shall report separately the incomes, disbursements, and liabilities of the two departments, of the life department upon the basis of receipts and disbursements, of the casualty department on an accrual basis."

All subsequent regulations of the Bureau of Internal Revenue promulgated by the commissioner, with the approval of the Secretary of the Treasury, provided that the income-tax returns of life-insurance companies should be made on the cash receipts and disbursements basis, and that the return, Form 1120-L, mentioned in Finding 1 hereof, which form of return was used by plaintiff for 1926, contains the instruction as to the basis upon which said return should be made, to wit, that "a return on this form shall be rendered on a cash receipts and disbursements basis in conformity with the annual statement made to the State insurance department instead of the accrual basis."

[fol. 9] 3. Plaintiff was required by the laws of Massachusetts to file, and it did file, with the State insurance commission of the Commonwealth annual statements (convention edition) for the calendar years 1925 and 1926 showing its financial condition for each year, and showing, among other things, its ledger assets, income, disbursements, and liabilities.

4. The plaintiff's annual statement, convention edition, to the insurance commission of Massachusetts for 1926 was filed with the Commissioner of Internal Revenue, which an-

nual statement contained in line 18, page 3, a statement that "Dividends $1,767,501.89 and interest $248,405.97 thereon held on deposit, surrendered during the year $2,015,907.86"; and on line 22, page 5, the statement that "Dividends left with the company to accumulate at interest, and accrued interest thereon, including $544,964.40, interest credited during the year and payable on demand $14,000,669.68." The item of $544,964.40 shown on line 22, page 5, of said annual statement was the amount of interest accrued and credited to plaintiff's policy holders during 1926, but not actually withdrawn or surrendered to the company by them during the year. The item of $248,405.97 shown on line 18, page 3, of said annual statement was the total amount of interest accrued and credited to the policyholders and actually withdrawn in cash or surrendered by said policyholders during the year 1926, irrespective of the year of origin. The major portion of this item originated in prior years. The record does not disclose the amount included therein which accrued on dividends and accumulations thereon for the year 1926.

5. The commissioner audited the return for 1926 and disallowed the deduction claimed by plaintiff for interest, and, instead, allowed a deduction of the amount of interest on dividends and accumulations held on deposit and withdrawn or surrendered during the year 1926 in the amount shown at line 18, page 3, of the annual report, $248,405.97. The commissioner determined an additional tax of $63,776.94, which was timely assessed and was paid by plaintiff under protest March 26, 1928, together with interest thereon of $3,539.18.

6. February 27, 1928, plaintiff duly filed a claim for refund for 1926 of $160,878.09, or such greater amount as should be legally refundable, upon the ground, among others, that it was entitled to a deduction from gross income of $544,964.40, interest accrued and credited to its policyholders during the year 1926 on dividends left by them to accumulate at interest, which deduction plaintiff had claimed on its return but which the commissioner had disallowed.

7. July 13, 1928, plaintiff received from the commissioner his undated overassessment certificate and schedules at-

tached thereto auditing the return for 1926 on the cash receipts and disbursements basis of accounting. This audit disclosed that in adjudicating the refund claim the commissioner disallowed the aforementioned item of $544,964.40 as a deduction from gross income and instead allowed an item of $248,405.97 as a deduction from gross income for the year, representing interest on dividends left by policyholders with the company to accumulate at interest, which [fol. 10] was actually withdrawn or surrendered by the policyholders during said year. The pertinent provisions of the certificate of overassessment are as follows:

"Net income reported on return		$1,670,818.96
Add:		
1. Interest on dividends left with company, item 22, page 5 of annual report		544,964.40
2. 4% of mean of reserve funds overstated		270,190.80
3. Taxes, item 10 of return, restored		33,882.42
4. Other real estate expense, item 11 of return, restored		40,770.33
Total		2,560,626.91
Deduct:		
5. Interest on dividends held on deposit and surrendered during the year, item 18, page 3 of annual report	$248,405.97	
6. Taxes and other expenses deductible	47,179.43	
7. Rent on home office building	89,100.00	
		384,685.40
Net income adjusted		$2,175,941.51"

"Explanation of Changes

"1 and 5. Interest payable on demand, shown as an accrual on line 22, page 5 of annual report, is not an allowable deduction. Interest on dividends held on deposit and surrendered during the year, shown on page 3 of annual report, line 18, constitutes an allowable deduction. Article 685, Regulations 69.

* * * * * * *

"Your contention that you are entitled to deduct interest on dividends left with the company, $544,964.40, shown on line 22, page 5, of annual report, can not be conceded from the evidence submitted. The interest deduction is limited to the amount shown on line 18, page 3, of your annual report."

8. The policy contract used by plaintiff during 1926 contained the provisions:

"This policy will participate at the end of the first policy year, and annually thereafter, in the distribution of the surplus funds of the company. At the option of the insured, dividends will be (1) paid in cash, or (2) applied in reduction of premiums, or (3) used to purchase participating paid-up additions, or (4) held by the company to accumulate subject to withdrawal on demand. If no election is made prior to any anniversary, the dividend for that anniversary will be held by the company to accumulate.

"Paid-up additions will have a cash surrender value (full reserve) but the company may, at its option, defer the granting of such surrender value for a period not exceeding ninety days from the date of the application therefor.

"Dividend accumulations will be credited at the end of each policy year with interest at such rate, not less than three per cent, as may be determined by the directors. Outstanding dividend accumulations will be added to the cash value of the policy in the event of surrender or to the amount payable under the policy if it becomes a claim by death.

"If this policy becomes a claim by death, the dividend for the current year will be paid in cash in addition to the sum insured."

[fol. 11] 9. October 4, 1928, plaintiff timely filed a further claim for refund for 1926 of $68,120.55, or such greater amount as should be legally refundable, solely on the ground that it was entitled to deduct from gross income said item of $544,964.40, representing income accrued and credited to its policyholders during the year on dividends left with the company to accumulate at interest, and accumulations thereon. No notice has been given to the plaintiff of any action on this claim by the commissioner.

Conclusion of Law

Upon the foregoing special findings of fact, which are made a part of the judgment herein, the court decides as a conclusion of law that the plaintiff is not entitled to recover, and its petition is therefore dismissed.

Judgment is rendered against plaintiff for the cost of printing the record herein, the amount thereof to be entered by the clerk and collected by him according to law.

Opinion

Littleton, Judge, delivered the opinion of the court:

The plaintiff, a life insurance company, was required by the revenue statute and the regulations of the Treasury Department in force during 1926 to determine its income and deductions, and compute its tax on the basis of receipts and disbursements as distinguished from an accrual basis.

The question in this case is whether the plaintiff is entitled to deduct from gross income for 1926, as interest paid, the amount of such interest credited to its policyholders during the year 1926. The policyholders were notified during the year of the amount of interest so credited and that it would be paid upon demand or handled in accordance with the terms of the policy contract, upon receipt of notice of the desire of the policyholder. The policy contract, under which the plaintiff became liable for the interest so credited, provided that it was "subject to withdrawal on demand." If a policyholder did not withdraw the interest or surrender it for application by the company in reduction of premiums or to purchase participating paid-up additions, it was allowed to accumulate and interest on such accumulations was thereafter credited to the policyholders. In these circumstances the plaintiff contends that interest in the amount of $544,964.40 credited to the policyholder was constructively paid by it and was a proper and legal deduction from gross income for the year in which credited.

The defendant insists that the interest item of $544,964.40 is purely an accrued item which, under the law and the regulations, is not an allowable deduction on the cash receipts and disbursements basis of accounting, which method of accounting the plaintiff was required to and did employ; that article 51 of Treasury Regulations 69, and prior regulations under prior revenue acts provide that "Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually re- [fol. 12] duced to possession. To constitute receipt in such a case the income must be credited to the taxpayer without any substantial limitation or restriction as to the time

or manner of payment or condition upon which payment is to be made. * * * If the income is not credited, but is set apart, such income must be unqualifiedly subject to the demand of the taxpayer, * * *" applies solely to the recipients of a credit when, according to the method of accounting employed by the taxpayer making the credit, there is a payment for income tax purposes; that the regulation therefore can have no application to a credit by a taxpayer employing the cash receipts and disbursements method of accounting.

The plaintiff relies upon Corliss v. Bowers, 281 U. S. 376; Commissioner v. Bingham, 35 Fed. (2d) 503; Hadley v. Commissioner, 36 Fed. (2d) 543; Chicago, R. I. & P. Ry. Co. v. Commissioner, 47 Fed. (2d) 990; Charleston & W. C. Ry. Co. v. Burnet, 50 Fed. (2d) 342; John A. Brander, 3 B. T. A. 231; Chipley v. Commissioner, 25 B. T. A. 1103. These cases are not applicable to the question here involved. The Corliss case involved income from a revocable trust and the Bingham and Hadley cases involved the question whether dividends declared and made unqualifiedly subject to the demand of the stockholders were income in the year in which declared and set apart. When a dividend is declared and set apart to the stockholders the amount thereof is separated from the invested capital of the corporation and the provisions of the above-quoted regulation have been consistently applied. Section 201 (e) of the revenue act of 1921 specifically provided that such dividends constitute income to the stockholders. The two railroad cases involved the question whether the amounts accrued and deducted by the corporations from gross income in the years credited but not paid constituted income to the corporations in subsequent years when the credits were charged to profit and loss. The Brander and Chipley cases involved the question whether a salary credited to an officer of a corporation employing the accrual method of accounting and available for withdrawal by him, constituted income, and the rule announced in the regulation quoted was applied. It will be seen, therefore, that in the ordinary case the question of constructive receipt of income arises where the taxpayer making the credit employs the accrual method of accounting. In such cases the credit constitutes a payment for tax purposes, and it has been consistently held that the person to whom the amount is

credited and made unqualifiedly subject to his demand may not escape taxation thereon by failing to withdraw it.

Other than in the administration of estates or trusts, as to which the statute specifically provides for a deduction of credits under certain circumstances, we know of no instance, and none has been called to our attention, in which it has been held that an amount credited but not paid by a taxpayer employing the cash receipts and disbursements method of accounting constitutes income to the person to whom credited. It is not claimed that the interest credited by the plaintiff to its policyholders during 1926 was taxed as income to them in that year by the commissioner. To hold that an amount credited by a taxpayer employing a cash receipts and disbursements method of accounting constitutes a payment, and is, therefore, deductible from gross income in the year in which credited, would destroy the dis-[fol. 13] tinction between the accrual and the receipts and disbursements methods of accounting which is recognized and made controlling by the revenue statutes. United States v. Anderson, 269 U. S. 422; United States v. Mitchell, 271 U. S. 9, 12. It follows therefore that plaintiff is not entitled to a deduction of the interest credited to its policyholders during 1926 on the ground that there was a constructive payment thereof in that year.

It is also urged by the plaintiff that section 245 (a) (8) of the revenue act of 1926 authorizes a deduction by insurance companies of interest paid or accrued, within the taxable year on its indebtedness. The language of this subsection is the same as section 234 (a) (2) relating to deductions by ordinary corporations, and section 214 (a) (2) relating to deductions by individuals, and, in our opinion, the term "paid or accrued" must be construed according to the method of accounting employed as provided in section 200 (d) of the revenue act of 1926. We think that in the enactment of subdivision (8) of section 245 (a), of the revenue act of 1926, Congress did not intend to make an exception in favor of insurance companies to the recognized rule that deductions from gross income should be determined in accordance with the method of accounting employed.

The petition is dismissed. It is so ordered.

Whaley, Judge; Williams, Judge; Green, Judge, and Booth, Chief Justice, concur.

VI. JUDGMENT

At a Court of Claims held in the City of Washington on the 31st day of May, A. D., 1932, judgment was ordered to be entered as follows:

Upon the special findings of fact, which are made a part of the judgment herein, the court decides as a conclusion of law that the plaintiff is not entitled to recover, and its petition is therefore dismissed.

[fol. 14] Clerk's certificate to foregoing transcript omitted in printing.

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed November 7, 1932

The petition herein for a writ of certiorari to the Court of Claims is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

FILE COPY

SEP 28 1932

Supreme Court of the United States

October Term, 1932.

No. 322.

THE MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY (A Corporation),
Petitioner,

v.

THE UNITED STATES,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

A. R. SERVEN,
GUY PATTEN,
Counsel for Petitioner.

PRESS OF THE SUDWARTH CO., WASHINGTON

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Supreme Court of the United States

October Term, 1932.

No. 322.

THE MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY (A Corporation),
Petitioner,

v.

THE UNITED STATES,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.
OPINION OF THE COURT BELOW.

The opinion of the court below has not yet been reported, but was rendered by the Court of Claims on May 31, 1932, and appears at page 16 of the Record herein.

II.
JURISDICTION.

1. Jurisdiction is invoked under Section 3 (b) of the Act approved February 13, 1925 (43 Stat. L. 939).

2. The judgment of the Court of Claims dismissing the petition was entered on May 31, 1932 (R. 19).

The petition for certiorari was filed on August 26, 1932.

3. Petitioner claimed in the court below that it was entitled to recover against the United States for internal revenue taxes overpaid by it for the year 1926, due to the disallowance by the Commissioner of Internal Revenue of interest accrued and credited to its policyholders during said year, subject to withdrawal on demand, to which it was entitled as a deduction from gross income under the provisions of Section 245 (a) (8) of the Revenue Act of 1926 (44 Stat. L. 47, 48) (R. 7, Am'd. Pet. VI, R. 12-14, Find. 4, 5, 6, 7). Its petition was dismissed by the judgment of the court below.

4. Attention is invited to the following cases, under which it is believed the writ prayed for should be granted:

Fields v. United States (205 U. S. 292; 51 L. Ed. 807).
Hamilton Brown Shoe Co. v. Wolf Bros. Co. (240 U. S. 251; 60 L. ed. 629).
Magnum Import Company v. Coty (262 U. S. 159; 67 L. ed. 922).

III.

STATEMENT OF THE CASE.

A full statement of all that is material to the case has been given under heading "A" in the petition for the writ (R. 1) and, in the interest of brevity, the statement will not be repeated here.

There is no question here in regard to the deduction of interest when actually withdrawn or

surrendered by the policyholders, as the petitioner is not claiming it is entitled to deduct interest when accrued and credited subject to withdrawal on demand, and again when actually withdrawn. (R. 10, 11).

IV.

SPECIFICATION OF ERRORS.

1. The Court of Claims erred in holding that interest accrued and unconditionally credited to policyholders during the tax year subject to withdrawal on demand, in compliance with the terms of the policy contracts, was not deductible from gross income for such year under the provisions of the tax act unless it was actually withdrawn by the policyholder during such tax year.

2. The Court of Claims erred in holding that petitioner's right under the tax act to the deduction of the interest involved here was dependent upon the method of accounting employed.

3. The Court of Claims erred in holding that in the enactment of subdivision (8) of Section 245 (a) of the Revenue Act of 1926 Congress did not intend to make an exception, in the case of life insurance companies, to the general rule that deductions from gross income should be determined in accordance with the method of accounting employed.

4. The Court of Claims erred in holding that to allow the deduction of interest accrued and credited to policyholders during the tax year subject to withdrawal on demand, in the case of life

insurance companies taxable under the special provisions of the Revenue Act relating to them, would destroy the distinction between the paid and the accrued methods of accounting, or that such distinction is applicable to this case.

5. The Court of Claims erred in holding, either directly or by analogy, that subdivision (8) of Section 245 (a) of the Revenue Act of 1926 is affected by the provisions of Section 200 (d) of said Act.

6. The Court of Claims erred in its failure to distinguish between purely an accrued item and an item which, immediately upon accrual, is set aside to the policyholder subject to withdrawal on demand.

V.

ARGUMENT.

The interest involved arose under the outstanding policy contracts of the company (R. 11, Find. 1) which provided that dividends left with the company will draw interest, that such interest will be set aside or credited to the policyholder each year as it accrues, and is subject to withdrawal on demand (R. 14, Find. 8). In the conduct of its business the company each year meets its said obligations in the manner provided, notifies each such policyholder in writing of the amount of such interest credited to him and in practice accepts such notices on demand for cash payment of the amount shown therein. (R. 11, Find. 1).

Statutes and Regulations.

The pertinent provisions of the Revenue Act

of 1926 and the Regulations of the Treasury Department thereunder are set forth in full in the Appendix hereto (P. 18). The following appear therein:

Section 245 (44 Stat. L. 48) (a) in the case of a life insurance company the term "net income" means the gross income less—

x x x x x x

(8) All interest paid or accrued within the taxable year on its indebtedness, * * *. (P. 25).

The Regulations.

Regulations 69, pertaining to the Revenue Act of 1926, provides by Article 685, subdivision (3) that—

> "The deduction allowed by Section 245 (a) (8) for interest on indebtedness is the same as that allowed other corporations by Section 234 (a) (2) (See Articles 561 and 121) but this deduction includes item 18 of the disbursement page of the annual statement of life companies to the extent that interest on dividends held on deposit and surrendered during the taxable year is included therein. Dividends left with the company to accumulate at interest are a debt and not a reserve liability." (P. 26).

Summary of the Argument.

A. The statute involved is clear and unambiguous, and the decision below is in conflict therewith.

B. The decision below is contrary to and in conflict with prior Federal court decisions upon an important general question of law applicable to this case.

C. The Regulations of the Bureau of Internal Revenue are in conflict with the Federal statute involved.

D. The question involves the construction of a Federal statute relating to a very large class of income tax payers, which has not been, but should be, settled by this court.

A.

THE STATUTE INVOLVED IS CLEAR AND UNAMBIGUOUS.

Succinctly stated, petitioner contends it is entitled to the deduction here claimed because the statute says so. Sections 242 to 245, inclusive, relate solely to life insurance companies and constitute a special statute for determining the income tax liability of this class of tax payers. These sections of the statute provide (P. 24-25) that "gross income" means the gross amount received during the taxable year from interest, dividends and rents, and that "net income" means gross income less—(certain deductions not involving payment), exempt interest received, dividends received, investment expenses paid, taxes and other expenses paid during the taxable year, and interest paid or accrued within the taxable year. The words "paid or accrued," as they appear in the provision for the deduction of interest, must be construed in connection with the other provisions so as to give an harmonious effect to the whole plan of Congress for determining the taxable net income of this class of tax payers. (*United States v. Landram*, 118 U. S. 81; 30 L. ed. 58; *Mason v.*

United States, 260 U. S. 545; 67 L. ed. 396; *Lawrence v. Allen*, 7 How. 785; 12 L. ed. 914; *Peck v. Jenness*, 7 How. 612; 12 L. ed. 841; *Bernier v. Bernier*, 47 U. S. 242; 37 L. ed. 152).

The foregoing plan of dealing with life insurance companies was first adopted by Congress in the Revenue Act of 1921 (42 Stat. L. 227), approved November 23, 1921. That Act likewise contained the same difference of expression with reference to the provision for the deuctions of interest, and that of other deductions, as appears in all the later Revenue Acts. Prior to the passage of the Revenue Act of 1921, the Treasury Department, on April 9, 1921, had ruled that life insurance companies were required to make their returns on the cash receipts and disbursements basis as distinguished from an accrual basis, as being in accordance with the method of accounting regularly employed by such companies, and such Regulation was duly published (R. 12, Find. 2). That Congress was familiar with the conditions of the business and said ruling of the Treasury Department is evidenced by the provisions of the Revenue Act of 1921, and like provisions in all subsequent Acts. The definite and specific terms of the legislation which followed emphasize the significance of the provision for the deduction of interest "paid or accrued." When it is considered that the business of life insurance companies is that of selling life insurance evidenced by written contracts, then the findings of the Court below covering the terms of those con-

tracts, the practice and method employed in transacting such business with policyholders, likewise familiar to it, explains why Congress provided for the deduction of interest in different terms than those relating to other items of receipt and disbursement. It was conforming its legislation to the conditions of the business. All interest as it accrued was in practice, in fact and pursuant to contract, credited under conditions equivalent to payment. It was set apart to policyholders subject to their demand. Its deduction from gross income in connection with the other provisions reflects the correct net result of the operations for the taxable year without involving transactions for any prior or subsequent year. In view of the whole plan it is logical that Congress should provide for the deduction of all interest accrued within the taxable year, whether actually paid or not. We believe this construction gives due weight, as any construction must if possible, to all the words of the statute, and is in harmony and consistent with the other provisions and the plan as a whole for determining the taxable net income of life insurance companies. (*Washington Market Co. v. Hoffman*, 101 U. S. 112; 25 L. ed. 782; *Brown v. Duchesne*, 19 How. 183; 15 L. ed. 595; *United States v. Voisdore*, 8 How. 113; 12 L. ed. 1009).

Right to Deduction Does Not Depend on Accounting Method Employed.

As above noted, the provisions of Sections 242 to 245, inclusive, of the Revenue Act are definite

and inflexible. Under those provisions there is no basis upon which a life insurance company can be taxed except that detailed in the statute. The method of accounting regularly employed by such companies, known to Congress, would seem in itself to explain why these provisions relating to life insurance companies are definitely fixed, while the provisions (P. 18-23) relating to individuals and other corporations, whose methods of accounting may widely differ, are expressly dependent upon the method employed. These fixed provisions relating solely to life insurance companies are not subject to any change in accounting methods which such a company might adopt, hence are not dependent upon the method employed. By the same measure, the question of whether the allowance of interest accrued and credited subject to demand under Section 245 (a) (8) would destroy the distinction between the paid and the accrued methods of accounting, not only becomes irrelevant, but Congress evidently considered it would not. This provision for the deduction of "All interest paid or accrued" is not so much an exception, in the case of life insurance companies, to the general rule that deductions from gross income should be determined in accordance with the method of accounting employed, as it is a provision based by Congress upon the known conditions of the business. The word "accrued" cannot be read out of the statute. If it be read as depending upon the method of accounting employed it can never have any meaning or operative effect under any cir-

cumstances, which amounts to the same thing, because the statute is definite and inflexible that all items of receipt and all other items of deduction involving payment, shall be returned on the cash basis. It is the purpose of taxing statutes to require returns that clearly reflect correct taxable income. It is a reasonable construction of the law that the same method be applied to both sides of the account. (*United States v. John J. Mitchell*, et al., 271 U. S. 9, at page 12; *United States v. Anderson*, 269 U. S. 422; *W. S. Barstow & Co. v. Bowers*, 2d C. C. A., 15 Fed. (2d) 75, 78).

But the above cases which laid down these principles were dealing with statutes and regulations under which the taxpayer might make his return on either the "paid" or "accrued" basis, depending upon the method of accounting employed by him. No such condition is possible under the provisions relating to life insurance companies involved here. But the deduction of all interest accrued and credited to policyholders during the taxable year does meet the rule of consistency and reflects the true net income of the company for such year, because such interest is actually set aside to the policyholders and thereafter is subject to their demands (R. 11, Find. 1) and not that of petitioner.

In the Report of the Committee on Ways and Means on H. R. 8245 (Revenue Bill of 1921), Report No. 350, p. 14 (Mr. Fordney), 67th Congress, 1st Session, it was said:

Life Insurance Companies.

"Sections 242-246: The provisions of the present law applicable to life insurance companies are imperfect and productive of constant litigation. Moreover, the taxes paid by life insurance companies under the income tax are inadequate. It is accordingly proposed in lieu of all other taxes to tax life insurance companies on the basis of their investment income from interest, dividends, and rents, with suitable deduction for expenses fairly chargeable against such investment income. x x x"

The deduction of interest on the basis here claimed being necessary to correctly reflect the true net income of a life insurance company, Congress so provided.

It is submitted that the deduction of interest set aside to policyholders subject to their demand is essential in order to determine the current year's income of the company and to avoid the taxation to it of a portion of its gross investment income which is not actually realized as income within the year.

Section 200 (d) Not Applicable.

Section 200 (d) (Appen. P. 18), by its own terms, expressly limits its provisions to those taxpayers whose "Net income is computed under Section 212 or 232."

Section 212 (Appen. P. 18), deals with individuals and Section 232 (Appen. P. 21) deals with corporations other than insurance companies. Both these classes of taxpayers are allowed to

make their returns on either the "paid" or "accrued" basis. The statute allows them to deduct (alike in Sections 214 and 234) "all x x x expenses paid or incurred during the taxable year," "all interest paid or accrued within the taxable year," "taxes paid or accrued within the taxable year." Congress therefore provided by Section 200 (d) that "The terms x x x 'paid or accrued'" shall be construed according to the method of accounting upon the basis of which the net income is computed under Section 212 or 232. Section 200 (d), so far as the provisions relating to life insurance companies are concerned, has no subject matter upon which to operate. Hence Congress, acting advisedly, limited the operation of Section 200 (d) to Sections 212 and 232.

B.

CONFLICT WITH PRIOR FEDERAL COURT DECISIONS.

In the background of this case is a general question of law which is important in determining the sense in which Congress used the word "accrued" in the interest deduction involved when considered in its relation to the other provisions of the statute relating to life insurance companies, i. e., the distinction between an accrual in the usual sense of the term, and to an accrual credited in such manner as to constitute constructive payment.

In *Hadley v. Commissioner of Internal Revenue* (36 Fed. (2d) 543), the Court of Appeals of the District of Columbia, in affirming a decision of the

United States Board of Tax Appeals (6 B. T. A. 1031), held that profits credited to stockholders of a corporation and unqualifiedly subject to their demand are constructively received when credited and constitute taxable dividends to the stockholders. In that case the court draws the exact distinction contended for by plaintiff in the case at bar when it says:

> "It does not clearly appear whether the taxpayer rendered his return on a cash or accrual basis, but we think this is not material, since the mere credit of his account with the earnings constituted an accrual. (*United States v. Anderson*, 269 U. S. 422 (T. D. 3839, C. B. V-I, 179). However, according to the practice of the Department, the amounts were constructively received when credited. Under article 4, paragraph 51, Treasury Regulations 33, article 53, it is provided as follows:
>
> 'Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. To constitute receipt in such a case the income must be credited to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made. A book entry, if made, should indicate an absolute transfer from one account to another. If the income is not credited, but is set apart, such income must be un-

qualifiedly subject to the demand of the taxpayer.'

x x x This distinction between receipt and accrual must be kept in mind. Income may accrue to the taxpayer and yet not be subject to his demand or capable of being drawn on or against by him.

"Clearly, under this rule, the earnings set aside in the present case must be construed as a receipt instead of an accrual, since the share of the earnings belonging to the appellant was not only placed to his credit on the books of the corporation, but was brought unqualifiedly subject to his demand. It was money available for his use as much as if it has been placed in his bank account subject to check."

In *Commissioner of Internal Revenue v. Bingham* (35 Fed. (2) 503), the Circuit Court of Appeals for the Sixth Circuit held that dividends actually received in 1923 by a stockholder whose books are kept on a cash receipts and disbursements basis are nevertheless required to be included in gross income in 1922, when they were declared and unqualifiedly subject to his demand.

The same principle is affirmed in *Charleston & Western Carolina Railroad Company v. Burnett* (No. 5074, decided by the Court of Appeals, District Eight, May 5, 1931, not yet reported), and *Chicago, Rock Island & Pacific Railroad Company v. Commissioner* (Circuit Court of Appeals, Seventh Circuit, 47 Fed. (2d) 990).

It is respectfully submitted that the decision of the court below, in its application of this general

question of law is in conflict with the foregoing decisions.

C.

REGULATIONS IN CONFLICT WITH FEDERAL STATUTES.

Treasury Regulations 69, Article 685, (Appen. P. 26) provides:

> "(3) The deduction allowed by Section 245 (a) (8) for interest on indebtedness is the same as that allowed other corporations by Section 234 (a) (2) (See articles 561 and 121) but this deduction includes item 18 of the disbursement page of the annual statement of life companies to the extent that interest on dividends held on deposit and surrendered during the taxable year is included therein. Dividends left with the company to accumulate at interest are a debt and not a reserve liability."

Article 561 provides:

> "Art. 561. Allowable Deductions—In general the deductions from gross income allowed corporations are the same as allowed individuals x x x."

Article 121 provides:

> "Art. 121. Interest—Interest paid or accrued within the year on indebtedness may be deducted from gross income, x x x."

Obviously Article 685 when read in connection with the references therein contained is intended to provide that the deduction allowed life insurance companies by Section 245 (a) (8) for interest on indebtedness is dependent upon the method

of accounting employed, with the further specific limitation that interest on dividends held on deposit may not be deducted unless actually withdrawn or surrendered by the policyholder during the taxable year. This question has been discussed under Point A herein and will not be repeated here. Upon the reasoning there adduced, it is respectfully submitted that the provisions of the Revenue Act (Sections 242 to 245, inclusive), are not susceptible to the restricted interpretation placed thereon in the foregoing Treasury Regulations, unless we indulge in the liberty of treating the word "accrued," in the provision for the deduction of interest on indebtedness, as superfluous, void or insignificent. Such treatment would violate the well established rule that effect must be given to all the words of a statute, when this is possible without conflict. (*United States v. Gooding*, 12 Wheat. 460; 6 L. ed. 693; *Montclair Twp. v. Ramsdell*, 107 U. S. 147; 27 L. ed. 431; *Early v. Doe, ex dem. Homans*, 16 How. 610; 14 L. ed. 1079; *Wilmot v. Mudge*, 103 U. S. 217; 26 L. ed. 536).

D.

A NEW AND SUBSTANTIAL QUESTION.

From all of the foregoing the petitioner respectfully submits that the question here is one of substance relating to the construction of a statute of the United States which has not been, but should be, settled by this Court. The Revenue Act of 1921 made a radical change in the basis of computing the net income of life insurance companies.

The plan then adopted by Congress has been followed in all subsequent Revenue Acts, including the Revenue Act of 1932. The provision for the deduction of interest on indebtedness, involved here, is alike in all said Acts. The construction of this provision has never been settled by this Court. The determination of the question here will settle it under all the Revenue Acts since and including the Revenue Act of 1921. It is of broad and general importance, as it affects a large class of income tax payers.

CONCLUSION.

It is, therefore, respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers, in order that a substantial question of great importance relating to the proper construction of a statute of the United States and affecting a large class of income tax payers may be settled by this Court, and that to such an end a writ of certiorari should be granted and this Court should review the decision of the Court of Claims and finally reverse it.

Respectfully submitted,

A. R. SERVEN,
GUY PATTEN,
Counsel for Petitioner.

APPENDIX.

The Statutes.

The pertinent provisions of the Revenue Act of 1926 read as follows:

TITLE II—INCOME TAX.

PART I.—GENERAL PROVISIONS.

Definitions.

Sec. 200 (44 Stat. 10). When used in this title—

x x x x x x

(d) The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212 or 232. The deductions and credits provided for in this title shall be taken for the taxable year in which "paid or accrued," or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed under section 212 or 232, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

Net Income of Individuals Defined.

Sec. 212. (44 Stat. 23). (a) In the case of an individual the term "net income" means the gross income as defined in section 213, less the deductions allowed by sections 214 and 206.

(b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the

method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 200 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

Gross Income Defined.

Sec. 213 (44 Stat. 23). For the purposes of this title, except as otherwise provided in section 233—

(a) The term "gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or

gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period.

Deductions Allowed Individuals.

Sec. 214. (44 Stat. 26). (a) In computing net income there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries x x x.

(2) All interest paid or accrued within the taxable year on indebtedness, x x x.

(3) Taxes paid or accrued within the taxable year x x x.

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business.

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; x x x.

(6) Losses sustained during the taxable year of property not connected with the trade or business (but in the case of a non-resident alien individual only property within the United States) if arising from fires, storms, shipwreck, or other casualty, or from theft,

and if not compensated for by insurance or otherwise. x x x.

(7) Debts ascertained to be worthless and charged off within the taxable year x x x.

(8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. x x x.

(9) x x x x
(10) x x x x
(11) x x x x

Net Income of Corporations Defined.

Sec. 232 (44 Stat. 41). In the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206, and the net income shall be computed on the same basis as is provided in subdivisions (b) and (d) of section 212 or in section 226. In the case of a foreign corporation or of a corporation entitled to the benefits of section 262 the computation shall also be made in the manner provided in section 217.

Gross Income of Corporations Defined.

Sec. 233 (44 Stat. 41). (a) In the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in sections 213 and 217, except that mutual marine insurance companies shall include in gross income the gross premiums collected and received by them less amounts paid for reinsurance.

Deductions Allowed Corporations.

Sec. 234. (44 Stat. 41). (a) In comput-

ing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, x x x.

(2) All interest paid or accrued within the taxable year on its indebtedness, x x x.

(3) Taxes paid or accrued within the taxable year x x x.

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise. x x x.

(5) Debts ascertained to be worthless and charged off within the taxable year x x x.

(6) The amount received as dividends x x x.

(7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence.

(8) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; x x x.

(9) In the case of insurance companies (other than life insurance companies), in addition to the above (unless otherwise allowed): (A) The net addition required by law to be made within the taxable year to reserve funds x x x.

(10) In the case of mutual marine insurance companies, there shall be allowed, in addition to the deductions allowed in paragraphs (1) to (9), inclusive, unless otherwise allowed, amounts repaid to policyholders

on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment and the payment thereof;

(11) In the case of mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life or mutual marine insurance companies) requiring their members to make premium deposits to provide for losses and expenses, there shall be allowed, in addition to the deductions allowed in paragraphs (1) to (9), inclusive, unless otherwise allowed, the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves.

x x x.

Tax on Insurance Companies.

Sec. 242. (44 Stat. 47). When used in this title the term "life insurance company" means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

Sec. 243. (44 Stat. 47). In lieu of the tax imposed by section 230, there shall be levied, collected, and paid for each taxable year upon the net income of every life insurance company a tax as follows:

(1) In the case of a domestic life insurance company, 12½ per centum of its net income;

(2) In the case of a foreign life insurance

company, 12½ per centum of its net income from sources within the United States.

Section 244. (44 Stat. 47). (a) In the case of a life insurance company the term "gross income" means the gross amount of income received during the taxable year from interest, dividends, and rents.

(b) x x x x

Sec. 245. (44 Stat. 47). (a) in the case of a life insurance company the term "net income" means the gross income less—

(1) The amount of interest received during the taxable year which under paragraph (4) of subdivision (b) of section 213 is exempt from taxation under this title;

(2) An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subdivision, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, x x x.

(3) The amount received as dividends (A) from a domestic corporation other than a corporation entitled to the benefits of section 262 and other than a corporation organized under the China Trade Act, 1922, x x x.

(4) An amount equal to 2 per centum of any sums held at the end of the taxable year as a reserve for dividends (other than dividends payable during the year following the taxable year) the payment of which is deferred for a period of not less than five years from the date of the policy contract;

(5) Investment expenses paid during the taxable year x x x.

(6) Taxes and other expenses paid during

the taxable year exclusively upon or with respect to the real estate owned by the company, not including taxes assessed against local benefits of a kind tending to increase the value of the property assessed, and not including any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property. x x x.

(7) A reasonable allowance for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence;

(8) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title; and

(9) x x x x

(b) No deduction shall be made under paragraphs (6) and (7) or subdivision (a) on account of any real estate owned and occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the rate of 4 per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied.

The Regulations.

Regulations 69, pertaining to the Revenue Act of 1926, provides by Article 685, subdivision (3), that—

> The deduction allowed by Section 245 (a) (8) for interest on indebtedness is the same as that allowed other corporations by Section 234 (a) (2) (See Articles 561 and 121) but this deduction includes item 18 of the disbursement page of the annual statement of life companies to the extent that interest on dividends held on deposit and surrendered during the taxable year is included therein. Dividends left with the company to accumulate at interest are a debt and not a reserve liability.

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DEC 1 1932

Supreme Court of the United States

October Term, 1932.

No. 322.

THE MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY,
(A Corporation), Petitioner,

vs.

THE UNITED STATES.

BRIEF FOR PETITIONER.

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PRESS OF THE SUDWARTH CO., WASHINGTON

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Supreme Court of the United States

October Term, 1932.

No. 322.

THE MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY,
(A Corporation), Petitioner,

vs.

THE UNITED STATES.

BRIEF FOR PETITIONER.

I.

Opinion of the Court Below.

The opinion of the Court of Claims (R. 16) is reported in 59 Fed. (2d) 116.

II.

Jurisdiction.

1. The judgment to be reviewed is that of the Court of Claims, dated May 31, 1932 (R. 19). Petition for writ of certiorari was filed August 26, 1932, and the petition was granted November 7, 1932 (R. 21).

2. The jurisdiction of this court is based upon Section 3 (b) of the act approved February 13, 1925 (43 Stat. 939), and Rule 38, 5 (b), (c) of the Revised Rules of this court, adopted June 8, 1925; in particular that part of the Rule citing as cases for granting a writ of certiorari a case where the lower court has decided an important question of substance relating to the construction of a statute of the United States, which has not been, but should be, settled by this court.

III.

Statement of the Case.

The object of this proceeding is to obtain a review of a judgment of the Court of Claims, dated May 31, 1932 (R. 19), denying to petitioner, a life insurance company, the right to deduct from gross income, in the determination of its Federal income tax liability for the year 1926, all interest accrued and credited to its policyholders during said year subject to withdrawal on demand but not actually withdrawn by them, on dividends left with it to accumulate at interest.

The petitioner, a Massachusetts corporation, during the year 1926, and for many years prior thereto, was engaged in the business of making and selling life insurance on the mutual level premium plan in Massachusetts and other states of the United States, and as such was subject to the Revenue Act of 1926 providing for the payment of income taxes for said year. (R. 11).

The policy contracts issued by the petitioner provide that such policy will participate annually in the distribution of the surplus funds of the company; that such dividends, at the option of the insured, among other things, will be paid in cash or may be left with the company to accumulate, subject to withdrawal on demand; and that dividends left to accumulate will be credited at the end of each policy year with interest at such rate, not less than three per cent, as may be determined by the directors, which interest is subject to withdrawal on demand. (R. 14, 15).

During the year 1926, the period involved in this case, each policyholder leaving dividends with the petitioner to accumulate was given credit in his individual account with the petitioner for his respective part of the interest which accrued thereon during said year and a regular form notice of the amount so credited was mailed to each such policyholder prior to the close of the year. Such interest was payable on demand and the policyholder was so advised. It was the practice of the petitioner to accept

such notice on demand for cash payment of the amount shown therein. (R. 11).

In the determination of petitioner's income tax liability for the year 1926 and the adjudication of its refund claims for said year, the Commissioner of Internal Revenue refused to allow petitioner to deduct from gross income the sum of $544,964.40, which was the amount of interest accrued and credited to its policyholders during said year but not actually withdrawn by them on dividends left with it to accumulate, and which (R. 11) petitioner had deducted in its tax return for said year. Instead thereof, said Commissioner allowed petitioner a deduction of $248,405.97, which was the amount of interest on dividend accumulations actually withdrawn or surrendered by its policyholders during said year, irrespective of the year of origin. The major portion of this item originated in prior years. (R. 12, 13).

There is no question here in regard to the deduction of interest when actually withdrawn or surrendered by the policyholder, as the petitioner is not claiming it is entitled to deduct interest when accrued and credited subject to withdrawal on demand and again when actually withdrawn. (R. 10, 11).

Petitioner claims it is entitled to recover the tax paid, with interest thereon as provided by law, on the difference between said amount claimed in its tax return ($544,964.40) and the

amount allowed by said Commissioner on a different basis, ($248,405.97), as a deduction, said difference ($296,558.43) representing the amount of interest accrued and credited to its policyholders for said year which it has not received as a deduction and which has substantially increased petitioner's income tax liability for said year.

IV.

Specification of Errors.

1. The Court of Claims erred in holding that interest accrued and unconditionally credited to policyholders during the tax year subject to withdrawal on demand, in compliance with the terms of the policy contracts, was not deductible from gross income for such year under the provisions of the tax act unless it was actually withdrawn by the policyholder during such tax year.

2. The Court of Claims erred in holding that petitioner's right under the tax act to the deduction of the interest involved here was dependent upon the method of accounting employed.

3. The Court of Claims erred in holding that in the enactment of subdivision (8) of Section 245 (a) of the Revenue Act of 1926 Congress did not intend to make an exception, in the case of life insurance companies, to the general rule that deductions from gross income should be determined in accordance with the method of accounting employed.

4. The Court of Claims erred in holding that to allow the deduction of interest accrued and credited to policyholders during the tax year subject to withdrawal on demand, in the case of life insurance companies taxable under the special provisions of the Revenue Act relating to them, would destroy the distinction between the paid and the accrued methods of accounting, or that such distinction is applicable to this case.

5. In the construction of the statute and its relation to the facts disclosed, the Court of Claims erred in its failure to distinguish between purely an accrued item and an item which, immediately upon accrual, is set aside to the policyholder subject to withdrawal on demand.

6. The Court of Claims erred in holding, either directly or by analogy, that subdivision (8) of Section 245 (a) of the Revenue Act of 1926 is affected by the provisions of Section 200 (d) of said Act.

V.

ARGUMENT.

Statutes and Regulations.

The pertinent provisions of the Revenue Act of 1926 and the Regulations of the Treasury Department thereunder are set forth in full in the Appendix hereto (p. 25). The following appears therein:

"Section 245 (a). In the case of a life in-

surance company the term 'net income' means the gross income less—

* * * * * * * * *

(8) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title." (p. 33).

The Regulations.

Regulations 69, pertaining to the Revenue Act of 1926, provides by Article 685, subdivision (3), that—

"The deduction allowed by Section 245 (a) (8) for interest on indebtedness is the same as that allowed other corporations by Section 234 (a) (2) (See Articles 561 and 121) but this deduction includes item 18 of the disbursement page of the annual statement of life companies to the extent that interest on dividends held on deposit and surrendered during the taxable year is included therein. Dividends left with the company to accumulate at interest are a debt and not a reserve liability. (p. 35).

Summary of Argument.

A. The statute involved is clear and unambiguous and the decision below is in conflict therewith.

1. The statute being unambiguous, Treasury Regulations in conflict therewith cannot be given the force and effect of law.

B. Under the statute, the right to the deduction involved is not dependent upon the method of accounting employed.

1. The deduction claimed, under the facts, does not destroy the distinction between the paid and the accrued methods of accounting.

2. In the construction of the statute in its relation to the facts disclosed, the Court of Claims erred in its failure to distinguish between purely an accrued item and an item which, immediately upon accrual, is set aside to the policyholder subject to withdrawal on demand.

3. Section 200 (d) of the statute is not applicable to the sections relating to life insurance companies.

A.

The statute involved is clear and unambiguous and the decision below is in conflict therewith.

It is the position of petitioner that, in the determination of its income tax liability for the year 1926, it is entitled to the deduction from gross income in the computation of net income of all interest accrued and credited to its policyholders during the taxable year on dividends left to accumulate at interest, because the statute in clear and unambiguous terms so provides. Sec-

tions 242 to 245, inclusive, of the Revenue Act of 1926 relate solely to life insurance companies and constitute a special statute for determining the income tax liability of this class of taxpayers. These sections of the statute provide: (App. p. 31).

> "Sec. 244 (a). In the case of a life insurance company the term 'gross income' means the gross amount of income received during the taxable year from interest, dividends, and rents."
>
> "Sec. 245 (a). In the case of a life insurance company the term 'net income' means the gross income less—
>
> (1) The amount of interest received during the taxable year which under paragraph (4) of subdivision (b) of section 213 is exempt from taxation under this title.
>
> * * * * * * * * * * *
>
> (3) The amount received as dividends (A) from a domestic corporation other than a corporation entitled to the benefits of section 262 and other than a corporation organized under the China Trade Act, 1922, * * *.
>
> * * * * * * * * * * *
>
> (5) Investment expenses paid during the taxable year, * * *.
>
> (6) Taxes and other expenses paid during the taxable year exclusively upon or with respect to the real estate owned by the company, * * *.
>
> * * * * * * * * * * *

(8) All interest paid or accrued within the taxable year on its indebtedness, * * *.

The other subdivisions of this Section relate to certain deductions not involving receipt or payment. Subdivision (2) provides for a compensating deduction as against gross investment income of 4 per centum of the mean of reserve funds held by the company for the benefit of its policyholders, and subdivision (4) of 2 per centum on dividends the payment of which is deferred. Subdivision (7) provides for depreciation on property; and subdivision (9) (b) provides that the company shall carry into gross income the rental value of space occupied by it in an amount not less than a sum which in addition to any rents received from other tenants will provide a net income of 4 per centum of the book value of the real estate so owned or occupied, as a compensating condition for the allowance of taxes, expenses and depreciation on such real estate.

The statute indicates that Congress undertook to deal with life insurance companies specifically, and in practically all respects differently from other classes of taxpayers. The words "paid or accrued," as they appear in the provision for the deduction of interest, must be construed in connection with the other provisions so as to give an harmonious effect to the whole plan of Congress for determining the taxable net income of this class of taxpayers. (*United States v. Landram*, 118 U. S. 81; 30 L. ed. 58; *Mason v. United*

States, 260 U. S. 545; 67 L. ed. 396; *Lawrence v. Allen*, 7 How. 785; 12 L. ed. 914; *Peck v. Jenness*, 7 How. 612; 12 L. ed. 841; *Bernier v. Bernier*, 47 U. S. 242; 37 L. ed. 152).

The foregoing plan of dealing with life insurance companies was first adopted by Congress in the Revenue Act of 1921 (42 Stat. 227), approved November 23, 1921. That Act likewise contained the same difference of expression with reference to the provision for the deduction of interest, and that of other deductions, as appears in all the later Revenue Acts. Prior to the passage of the Revenue Act of 1921, the Treasury Department, on April 9, 1921, had ruled that life insurance companies were required to make their returns on the cash receipts and disbursements basis as distinguished from an accrual basis, as being in accordance with the method of accounting regularly employed by such companies, and such Regulation was duly published (R. 12, Find. 2). That Congress was familiar with the conditions of the business and said ruling of the Treasury Department is evidenced by the provisions of the Revenue Act of 1921, and like provisions in all subsequent Acts. The definite and specific terms of the legislation which followed emphasize the significance of the provision for the deduction of interest "paid or accrued." When it is considered that the business of life insurance companies is that of selling life insurance, evidenced by written contracts, then the findings of the Court

below covering the terms of those contracts, the practice and method employed in transacting such business with the policyholders, likewise familiar to it, explains why Congress provided for the deduction of interest in different terms than those relating to other items of receipt and disbursement. It was conforming its legislation to the conditions of the business. All interest as it accrued was in practice, in fact and pursuant to contract credited under conditions equivalent to payment. It was set apart to policyholders subject to their demand. Its deduction from gross income in connection with the other provisions reflects the correct net result of the operations for the taxable year without involving transactions for any prior or subsequent year. Congress adopted the plan of taxing life insurance companies on the basis of their investment income from interest, dividends, and rents, with suitable deductions for expenses properly chargeable against such investment income. In view of this plan it is logical that Congress should provide for the deduction of all interest accrued within the taxable year, whether actually paid or not. It is deductible if paid or if accrued within the taxable year, but not both, hence the term "paid or accrued." When regard is had to the other provisions of the Act relating to life insurance companies, we find no language which in any manner qualifies this provision. We believe this construction gives due weight, as any construction

must if possible, to all the words of the statute, and is in harmony and consistent with the other provisions and the plan as a whole for determining the taxable net income of life insurance companies. (*Washington Market Co. v. Hoffman*, 101 U. S. 112; 25 L. ed. 782; *Brown v. Duchesne*, 19 How. 183; 15 L. ed. 595; *United States v. Boisdore*, 8 How. 113; 12 L. ed. 1009).

Treasury Regulations Not Controlling.

It is urged by the Government that the Treasury Regulations, in accordance with which the Commissioner determined (and which was approved by the court below) that only interest actually paid was deductible, are controlling in this case. It is a familiar principle that in the interpretation of a doubtful or ambiguous statute the interpretation of those charged with its administration is entitled to great weight. But, it is respectfully submitted that principle is not applicable here. There is no ambiguity in the provision of Section 245 (a) (8) of the Act for the deduction of interest "paid or accrued." Obviously, Article 685 when read in connection with the references therein contained is intended to provide that the deduction allowed life insurance companies by Section 245 (a) (8) for interest on indebtedness is dependent upon the method of accounting employed, with the further specific limitation that interest on dividends held on deposit may not be deducted unless actually withdrawn

or surrendered by the policyholder during the taxable year. As heretofore pointed out, it is not believed that the provisions of the Revenue Act (Sections 242 to 245, inclusive), are susceptible to the restricted interpretation placed thereon in the foregoing Treasury Regulations, unless the word "accrued," in the provision for the deduction of interest on indebtedness, be treated as superfluous, void or insignificant. Such treatment would violate the well established rule that effect must be given to all the words of a statute, when this is possible without conflict. (*United States v. Gooding*, 12 Wheat. 460; 6 L .ed. 693; *Montclair Twp. v. Ramsdell*, 107, U. S. 147; 27 L. ed. 431; *Early v. Doe, ex. dem. Homans*, 16 How. 610; 14 L. ed. 1079; *Wilmot v. Mudge*, 103 U. S. 217; 26 L. ed. 536).

The distinction between *McCaughn v. Hershey Chocolate Co.*, 283 U. S. 488, which involved a doubtful or ambiguous statute, *Fawcus Machine Company v. United States*, 282 U. S. 375, and *Brewster v. Gage*, 280 U. S. 327, in which the court found that the regulations were not in conflict with or did no violence to the letter or spirit of the Act, and the prinicples involved here is clearly reflected in *Iselin v. United States*, 270 U. S. 245, 250, 251, in which the court said:

> "Congress undertook to accomplish its purpose by dealing specifically, and in some respects differently, with different classes of tickets and with tickets of any one class un-

der different situations. The particularization and detail with which the scope of each provision, the amount of the tax thereby imposed, and the incidence of the tax, were specified, preclude an extension of any provision by implication to any other subject. The statute was evidently drawn with care. Its language is plain and unambiguous. What the government asks is not a construction of a statute, but, in effect, an enlargement of it by the court, so that what was omitted, presumably by inadvertence, may be included within its scope. To supply omissions transcends the judicial function."

"The government calls attention to the fact that, as early as October 24, 1919, the Commissioner of Internal Revenue made the ruling pursuant to which the tax here in question was assessed; that on March 22, 1920, the Attorney General sustained that ruling; that the provisions here in question were re-enacted without substantial change in the Revenue Act of 1921 * * * and the Revenue Act of 1924 * * *; and that the administrative practice adopted in 1919 has been steadfastly pursued. It suggests that these facts imply legislative recognition and approval of the executive construction of the statute. But the construction was neither uniform, general, nor long continued; neither is the statute ambiguous. Such departmental construction cannot be given the force and effect of law."

This distinction is likewise observed in *Louisville & Nashville Railroad Co. v. United States*, 282 U. S. 740, wherein the court says:

"The act has been repeatedly amended, and has been re-enacted, without any change directed to the correction of this practice. It is strongly urged that in the light of these circumstances the administrative construction should be determinative. The principle is a familiar one that in the interpretation of a doubtful or ambiguous statute the long-continued and uniform practice of the authorities charged with its administration is entitled to great weight, and will not be disturbed except for cogent reasons. * * *. But that principle does not go far enough to control the decision here. There is no ambiguity in the requirement of Section 6 (1) of the act that its provisions as to published tariffs 'shall apply to all traffic, transportation, and facilities defined in this act.' "(757)

"Long continued practice and the approval of administrative authorities may be persuasive in the interpretation of doubtful provisions of a statute, but cannot alter provisions that are clear and explicit when related to the facts disclosed. A failure to enforce the law does not change it." (759)

B.

Under the statute, the right to the deductions involved is not dependent upon the method of accounting employed.

As above noted, the provisions of Sections 242 to 245, inclusive, of the Revenue Act are definite and inflexible. Under those provisions there is no basis upon which a life insurance company can be taxed except that detailed in the statute. The method of accounting regularly employed by

such companies, known to Congress, would seem in itself to explain why these provisions relating to life insurance companies are definitely fixed, while the provisions of Sections 213 and 214 (App. p. 26, 27) relating to individuals, and Sections 232, 233 and 234, (App. p. 28, 29) relating to corporations other than insurance companies, whose methods of accounting may widely differ, are expressly dependent upon the method employed. These fixed provisions relating solely to life insurance companies are not subject to any change in accounting methods which such a company might adopt, hence are not dependent upon the method employed. It is believed that the words "paid or accrued" should be construed in connection with the provisions relating solely to life insurance companies, instead of other and different parts of the Act. This distinction is observed in *Atlantic Cleaners & Dyers v. United States*, 286 U. S. 432, 433; 76 L. ed. 1204, wherein the court says:

> "Where the subject matter to which the words refer is not the same in the several places where they are used, or the conditions are different, or the scope of the legislative power exercised in one case is broader than that exercised in another, the meaning well may vary to meet the purposes of the law, to be arrived at by a consideration of the language in which those purposes are expressed, and of the circumstances under which the language was employed."

The deduction claimed, under the facts, does not destroy the distinction between the paid and the accrued methods of accounting.

By the same measure, the question whether the allowance of interest accrued and credited subject to demand under Section 245 (a) (8) would destroy the distinction between the paid and the accrued methods of accounting, not only becomes irrelevant, but Congress evidently considered it would not. This provision for the deduction of "All interest paid or accrued" is not so much an exception, in the case of life insurance companies, to the general rule that deductions from gross income should be determined in accordance with the method of accounting employed, as it is a provision based by Congress upon the known conditions of the business. The word "accrued" cannot be read out of the statutes. If it is read as depending upon the method of accounting employed it can never have any meaning or operative effect under any circumstances, which amounts to the same thing, because the statute is definite and inflexible that all items of receipt and all other items of deduction involving payment, shall be returned on the cash basis. It is the purpose of taxing statutes to require returns that clearly reflect correct taxable income. While it is a reasonable construction of the law, when applied to a case coming within its provisions, that the same method be applied to both sides of the ac-

count, (*United States v. John J. Mitchell*, et al., 271 U. S. 9, at page 12; *United States v. Anderson*, 269 U. S. 422; *W. S. Barstow & Co. v. Bowers*, 2d C. C. A. 15 Fed. (2d) 75, 78), the above cases which laid down this principle were dealing with statutes and regulations under which the taxpayer might make his return on either the "paid" or "accrued" basis, depending upon the method of accounting employed by him. No such condition is possible under the provisions relating to life insurance companies. But in their case, the deduction of all interest accrued and credited to policyholders during the taxable year does meet the rule of consistency and reflects the true net income of the company for such year, because such interest is actually set aside to the policyholders and thereafter is subject to their demands (R. 11, Find. 1) and not that of petitioner.

In the Report of the Committee on Ways and Means on H. R. 8245, (Revenue Bill of 1921), Report No. 350, p. 14 (Mr. Fordney), 67th Congress, 1st Session, it was said:

> "Life Insurance Companies.
>
> Sections 242-246: The provisions of the present law applicable to life insurance companies are imperfect and productive of constant litigation. Moreover, the taxes paid by life insurance companies under the income tax are inadequate. It is accordingly proposed in lieu of all other taxes to tax life insurance companies on the basis of their investment income from interest, dividends,

> and rents, with suitable deduction for expenses fairly chargeable against such investment income, * * *."

The deduction of interest on the basis here claimed being necessary to correctly reflect the true net income of a life insurance company, Congress so provided.

It is submitted that the deduction of interest set aside to policyholders subject to their demand is essential in order to determine the current year's income of the company and to avoid the taxation to it of a portion of its gross investment income which is not actually realized as income within the year.

> Distinction between an accrual and an accrual set aside subject to withdrawal on demand.

The provisions of the statute become clear and explicit when related to the facts disclosed. In the construction of the statute, and especially in its relation to the facts disclosed, it is believed the court below erred in its failure to distinguish between an accrual in the usual sense of the term and an accrual unqualifiedly credited subject to withdrawal on demand. It is this distinction, as heretofore pointed out, which we believe explains why Congress differentiated between the deduction for interest and the other deductions provided for in Section 245, *supra.*

In *Hadley v. Commissioner of Internal Revenue,* (36 Fed. (2d) 543), the Court of Appeals of

the District of Columbia, in affirming a decision of the United States Board of Tax Appeals (6 B. T. A. 1031), held that profits credited to stockholders of a corporation and unqualifiedly subject to their demand are constructively received when credited and constitute taxable dividends to the stockholders. In that case the court draws the exact distinction contended for by petitioner in the case at bar when it says:

> "It does not clearly appear whether the taxpayer rendered his return on a cash or accrual basis, but we think this is not material, since the mere credit of his account with the earnings constituted an accrual, (*United States v. Anderson*, 269 U. S. 422; T. D. 3839, C. B. V.-I, 179). However, according to the practice of the Department, the amounts were constructively received when credited.
>
> "* * * This distinction between receipt and accrual must be kept in mind. Income may accrue to the taxpayer and yet not be subject to his demand or capable of being drawn on or against by him.
>
> "Clearly, under this rule, the earnings set aside in the present case must be construed as a receipt instead of an accrual, since the share of the earnings belonging to the appellant was not only placed to his credit on the books of the corporation, but was brought unqualifiedly subject to his demand. It was money available for his use as much as if it had been placed in his bank account subject to check."

In *Commissioner of Internal Revenue v. Bingham*, (35 Fed. (2d) 503), the Circuit Court of Appeals for the Sixth Circuit held that dividends actually received in 1923 by a stockholder whose books are kept on a cash receipts and disbursements basis are nevertheless required to be included in gross income in 1922, when they were declared and unqualifiedly subject to his demand.

The same principle is affirmed in *Charleston & Western Carolina Railroad Company v. Burnett*, 50 Fed. (2d) 342, and *Chicago, Rock Island & Pacific Railroad Company v. Commissioner* (Circuit Court of Appeals, Seventh Circuit, 47 Fed. (2d) 990).

Section 200 (d) of the statute is not applicable to the sections relating to life insurance companies.

Section 200 (d) of the Revenue Act of 1926 (App. p. 25) provides:

> "(d) The terms 'paid or incurred' and 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212 or 232. The deductions and credits provided for in this title shall be taken for the taxable year in which 'paid or accrued,' or 'paid or incurred,' dependent upon the method of accounting upon the basis of which the net income is computed under section 212 or 232, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period."

Section 200 (d) by its own terms expressly limits its application to those taxpayers whose net income is computed under Section 212 or 232.

Section 212 (App. p. 25) deals with individuals and section 232 (App. p. 28) deals with corporations other than insurance companies. Both these classes of taxpayers are allowed to make their returns on either the paid or accrued basis. The statute allows them to deduct (alike in Section 214 and 234) "all * * * expenses paid or incurred during the taxable year," "all interest paid or accrued within the taxable year," "taxes paid or accrued within the taxable year." Congress therefore provided by Section 200 (d) that "The terms * * * 'paid or incurred' and 'paid or accrued'" shall be construed according to the method of accounting upon the basis of which the net income is computed under Section 212 or 232. Section 200 (d), so far as the provisions relating to life insurance companies are concerned, has no subject matter upon which to operate. Hence Congress, acting advisedly, limited the operation of Section 200 (d) to Sections 212 and 232. This leaves Sections 242 to 245, inclusive, clear and unambiguous and Section 200 (d) is an aid to such clarity. Likewise, Section 200 (d) when read in connection with said provisions relating to life insurance companies would seem to exclude any interpretation that the right to the deduction of interest on indebtedness involved here is dependent upon the method of ac-

counting employed. This distinction is observed in *United States v. Mitchell, supra.* In that case the net income of the taxpayer was computed under Section 212 of the applicable Revenue Act, hence the provisions of Section 200 were invoked.

CONCLUSION.

Inasmuch, then, as the statute in clear and unambiguous terms provides for the deduction of interest accrued; since the statute nowhere contains any limitation or qualification of this provision; and since the method provided by the statute, when considered in its relation to the facts disclosed, if followed, reflects the correct net results of the operations for the taxable year, it is believed that the judgment of the court below should be reversed.

Respectfully submitted,

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Of Counsel.

APPENDIX.

The Statutes.

The pertinent provisions of the Revenue Act of 1926 read as follows:

TITLE II—INCOME TAX.

PART I.—GENERAL PROVISIONS.

Definitions.

Sec. 200 (44 Stat 10). When used in this title—

* * * * * * * * *

(d) The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212 or 232. The deductions and credits provided for in this title shall be taken for the taxable year in which "paid or accrued," or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed under section 212 or 232, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

Net Income of Individuals Defined.

Sec. 212. (44 Stat. 23). (a) In the case of an individual the term "net income" means the gross income as defined in section 213, less the deductions allowed by sections 214 and 206.

(b) The net income shall be computed upon the basis of the taxpayer's annual ac-

counting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 200 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

Gross Income Defined.

Sec. 213 (44 Stat. 23). For the purposes of this title, except as otherwise provided in section 233—

(a) The term "gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing

out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period.

Deductions Allowed Individuals.

Sec. 214. (44 Stat. 26). (a) In computing net income there shall be allowed as deductions—

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries * * *.

(2) All interest paid or accrued within the taxable year on indebtedness, * * *.

(3) Taxes paid or accrued within the taxable year, * * *.

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business.

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *.

(6) Losses sustained during the taxable year of property not connected with the trade or business (but in the case of a non-resident alien individual only property within the United States) if arising from fires, storms, shipwreck, or other casualty, or from theft, and if not compensated for by insurance or otherwise. * * *.

(7) Debts ascertained to be worthless and charged off within the taxable year. * * *.

(8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. * * *.

Net Income of Corporations Defined.

Sec. 232 (44 Stat. 41). In the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206, and the net income shall be computed on the same basis as is provided in subdivisions (b) and (d) of section 212 or in section 226. In the case of a foreign corporation or of a corporation entitled to the benefits of section 262 the computation shall also be made in the manner provided in section 217.

Gross Income of Corporations Defined.

Sec. 233 (44 Stat. 41). (a) In the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in sections 213 and 217, except that mutual marine insurance companies shall include in gross income

the gross premiums collected and received by them less amounts paid for reinsurance.

Deductions Allowed Corporations.

Sec. 234. (44 Stat. 41). (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *.

(2) All interest paid or accrued within the taxable year on its indebtedness. * * *.

(3) Taxes paid or accrued within the taxable year. * * *.

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise. * * *.

(5) Debts ascertained to be worthless and charged off within the taxable year. * * *.

(6) The amount received as dividends * * *.

(7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence.

(8) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; * * *.

(9) In the case of insurance companies (other than life insurance companies), in addition to the above (unless otherwise al-

lowed): (A) The net addition required by law to be made within the taxable year to reserve funds * * *.

(10) In the case of mutual marine insurance companies, there shall be allowed, in addition to the deductions allowed in paragraphs (1) to (9), inclusive, unless otherwise allowed, amounts repaid to policyholders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment and the payment thereof;

(11) In the case of mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life or mutual marine insurance companies) requiring their members to make premium deposits to provide for losses and expenses, there shall be allowed, in addition to the deductions allowed in paragraphs (1) to (9), inclusive, unless otherwise allowed, the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves.

Taxes on Insurance Companies.

Sec. 242. (44 Stat. 47). When used in this title the term "life insurance company" means an insurance company engaged in the business of issuing life insurance and annunity contracts (including contracts of combined life, health and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

Sec. 243. (44 Stat. 47). In lieu of the tax imposed by section 230, there shall be levied, collected, and paid for each taxable year upon the net income of every life insurance company a tax as follows:

(1) In the case of a domestic life insurance company, 12½ per centum of its net income;

(2) In the case of a foreign life insurance company, 12½ per centum of its net income from sources within the United States.

Section 244. (44 Stat. 47). (a) In the case of a life insurance company the term "gross income" means the gross amount of income received during the taxable year from interest, dividends, and rents.

(b) The term "reserve funds required by law" includes, in the case of assessment insurance, sums actually deposited by any company or association with State or Territorial officers pursuant to law as guaranty or reserve funds, and any funds maintained under the charter or articles of incorporation of the company or association exclusively for the payment of claims arising under certificates of membership or policies issued upon the assessment plan and not subject to any other use.

Section 245. (44 Stat. 47. (a) In the case of a life insurance company the term "net income" means the gross income less—

(1) The amount of interest received during the taxable year which under paragraph (4) of subdivision (b) of section 213 is exempt from taxation under this title.

(2) An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subdivision, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, plus (in case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be neecssary for the protection of the holders of such policies only;

(3) Th amount received as dividends (A) from a domestic corporation other than a corporation entitled to the benefits of section 262, and other than a corporation organized under the China Trade Act, 1922, or (B) from any foreign corporation when it is shown to the satisfaction of the Commissioner that more than 50 per centum of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the foreign corporation has been in existence) was derived from sources within the United States as determined under section 217.

(4) An amount equal to 2 per centum of any sums held at the end of the taxable year as a reserve for dividends (other than dividends payable during the year following the taxable year) the payment of which is de-

ferred for a period of not less than five years from the date of the policy contract;

(5) Investment expenses paid during the taxable year: *Provided*, That if any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 per centum of the book value of the mean of the invested assets held at the beginning and end of the taxable year;

(6) Taxes and other expenses paid during the taxable year exclusively upon or with respect to the real estate owned by the company, not including taxes assessed against local benefits of a kind tending to increase the value of the property assessed, and not including any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property. The deduction allowed by this paragraph shall be allowed in the case of taxes imposed upon a shareholder of a company upon his interest as shareholder, which are paid by the company without reimbursement from the shareholder, but in such cases no deduction shall be allowed the shareholder for the amount of such taxes.

(7) A reasonable allowance for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence.

(8) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally sub-

scribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title; and

(9) In the case of a domestic life insurance company, the net income of which (computed without the benefit of this paragraph) is $25,000 or less, the sum of $2,000; but if the net income is more than $25,000 the tax imposed by section 243 shall not exceed the tax which would be payable if the $2,000 credit were allowed, plus the amount of the net income in excess of $25,000.

(b) No deduction shall be made under paragraphs (6) and (7) of subdivision (a) on account of any real estate owned and occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the rate of 4 per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied.

(c) In the case of a foreign life insurance company the amount of its net income for any taxable year from sources within the United States shall be the same proportion of its net income for the taxable year from sources within and without the United States, which the reserve funds required by law and held by it at the end of the taxable year upon business transacted within the United States is of the reserve funds held by it at the

end of the taxable year upon all business transacted.

The Regulations.

Regulations 69, pertaining to the Revenue Act of 1926, provides by Article 685, subdivision (3), that—

> The deduction allowed by Section 245 (a) (8) for interest on indebtedness is the same as that allowed other corporations by Section 234 (a) (2) (See Articles 561 and 121) but this deduction includes item 18 of the disbursement page of the annual statement of life companies to the extent that interest on dividends held on deposit and surrendered during the taxable year is included therein. Dividends left with the company to accumulate at interest are a debt and not a reserve liability.

Office Supreme Court
OCT 18 1932
CHARLES ELMORE

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No. 322

In the Supreme Court of the United States

OCTOBER TERM, 1932

THE MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY, PETITIONER

v.

THE UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the petitioner, a life insurance company making its return upon the basis of actual receipts and disbursements, is entitled to deduct from its gross income for 1926, as interest paid, the amount of interest credited by it to its policyholders during 1926 but not withdrawn by them.

STATUTES AND REGULATIONS INVOLVED

Section 245 of the Revenue Act of 1926, c. 27, 44 Stat. 9, 47, provides in part:

> SEC. 245 (a) In the case of a life insurance company the term "net income" means the gross income less—
>
> * * * * *
>
> (8) All interest paid or accrued within the taxable year on its indebtedness * * *;

Article 685 of Treasury Regulations 69, promulgated under the Revenue Act of 1926, provides in part:

> (3) The deduction allowed by section 245 (a) (8) for interest on indebtedness is the same as that allowed other corporations by section 234 (a) (2) (see articles 561 and 121), but this deduction includes item 18 of the disbursement page of the annual statement of life companies to the extent that interest on dividends held on deposit and surrendered during the taxable year is included therein. Dividends left with the company to accumulate at interest are a debt and not a reserve liability.

STATEMENT

The findings of fact made by the Court of Claims (R. 11–15) may be summarized as follows:

Petitioner, a Massachusetts corporation, is a mutual life insurance company. (R. 11.) Its plan of operation contemplates the return to its policyholders, in the form of "dividends," of a portion of its earnings. Its policies provide that the dividends, when declared, may be withdrawn in cash, applied in various ways as premium payments, or allowed to remain on deposit with petitioner. (R. 15.) If the policyholder adopts the last course, the dividends accumulate at interest, which is added to the dividends at the end of each policy year. The dividends and accrued interest may be withdrawn by the policyholder on demand. (R. 15.) During 1926, the taxable year now in question, for which petitioner filed its income tax on the basis of actual receipts and disbursements, $544,964.40 became due the policyholders as interest on their dividends left with petitioner. (R. 11.) This amount was credited to the individual accounts of the policyholders during 1926 and was subject to withdrawal on demand. The amount of interest actually withdrawn during 1926, however, was only $248,405.97, all of which did not accrue in 1926. (R. 13.) In its income-tax return for 1926 petitioner sought to deduct as interest paid during that year the total amount, $544,964.40, credited to the policyholders' accounts, whether or not actually

paid out. (R. 11.) The Commissioner disallowed the deduction claimed by petitioner, and instead allowed a deduction only of the interest withdrawn by the policyholders. (R. 13.) Petitioner paid the additional tax resulting from the Commissioner's determination of its net income, duly filed its claim for refund (R. 13), and brought this suit to recover the additional tax. The Court of Claims dismissed its petition. (R. 19.)

ARGUMENT

The Commissioner's determination (approved by the court below) that only interest actually paid was deductible, is in accordance with Treasury Regulations that are controlling in this case.

Under Section 245 (a) (8) of the Revenue Act of 1926, *supra,* petitioner could deduct from its gross income "interest paid or accrued within the taxable year." The phrase "paid or accrued" is, under Section 200 (d) of the 1926 Act, to be construed according to the method of accounting employed by the taxpayer. In the case of life insurance companies, Treasury rulings in force since 1921 required returns to be made on the cash receipts basis, as being in accordance with the method of accounting employed by such companies.[1]

---

[1] See *Bulletin H, Income Tax Rulings Peculiar to Life Insurance Companies*, published April 9, 1921:

"1. *Basis of returns.*—Returns of life insurance companies shall be made on a receipts and disbursements basis, as distinguished from an accrual basis, as being in accordance with the method of accounting regularly employed by such companies. * * *."

Treasury Regulations 62, Art. 685 (3), applicable to Section 245 (a) (8) referred to above, provided in effect that the interest payable by insurance companies on dividends that might be deducted was the amount paid out during the taxable year.[2] The statute was reenacted as Section 245 (a) (8) of the 1924 Act, 43 Stat. 253, 289, after this administrative interpretation, and the Regulations were carried forward into Regulations 65, Art. 685 (3). The provisions of the 1924 Act were reenacted without change in Section 245 (a) (8) of the 1926 Act, 44 Stat. 9, 47, and the Regulations were carried forward into Regulations 69, Art. 685 (3). The repetition was carried on in Section 203 (8) of the 1928 Act, 45 Stat. 791, 842, and in Regulations 74, Art. 975 (3).

Thus, the administrative interpretation of the term "paid or accrued" as applied to interest on dividends has, in the case of life insurance companies, been consistent and uniform. Petitioner argues that the Regulations are inconsistent with the Act, but the reenactment of the statute must be

[2] The Regulations provide that the deduction for interest on indebtedness "includes item 18 of the disbursement page of the annual statement of life companies * * *." Item 18 is the item that shows the amount of dividends and interest "surrendered during the year." In the instant case, the Commissioner allowed as a deduction the interest shown on item 18 of petitioner's annual statement as having been "surrendered," that is, actually paid during the taxable year. (R. 13.)

regarded as an adoption and ratification of the construction given it by the officers charged with its enforcement. See *McCaughn* v. *Hershey Chocolate Co.*, 283 U. S. 488, 492; *Fawcus Machine Co.* v. *United States*, 282 U. S. 375, 378; *Brewster* v. *Gage*, 280 U. S. 327, 336. The clear intent of the statutes and Regulations was that insurance companies should deduct from their gross income only such sums as they actually disbursed.

Petitioner contends that this construction of the statute virtually eliminates the words "or accrued" from the interest provision of Section 245 (a) (8). Since all life insurance companies, so far as we are informed, keep their books upon a cash receipts basis and hence can deduct only interest paid out during the taxable year, the correctness of petitioner's contention may be conceded. It may be noted that Section 245 (a) (8) is in the exact wording of Section 234 (a) (2), 44 Stat. 9, 41, applicable to corporations in general, and that the statute was drafted without the modification that would fit it more accurately to the accounting methods of life insurance companies. The superfluous words, however, do not help the petitioner. In *United States* v. *Mitchell*, 271 U. S. 9, a taxpayer upon the cash receipts basis attempted to deduct an estate tax which accrued during the taxable year but was not paid until later. This Court held that under the 1918 Revenue Act allowing a deduction of "taxes paid or accrued within the taxable year" the estate

tax could not be deducted until in fact paid. See also *The Barto Co.* v. *Commissioner,* 21 B. T. A. 1197; *Utah Orpheum Co.* v. *Commissioner,* 3 B. T. A. 1041; *Appeal of Seaboard Oil Co.,* 1 B. T. A. 1259. In the instant case the petitioner was on the cash receipts basis, and the court below therefore correctly held that a deduction for interest could not be taken until it had been withdrawn by the policyholder.

Petitioner also contends that it "constructively paid" the interest during 1926, since, by Regulations 69, Art. 51, "Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession * * *." Cases cited by petitioner support the Regulations, and show that taxpayers, even though they keep their books on the cash receipts basis, may "constructively receive" income in circumstances like the present. But "constructive payment" by a taxpayer is not covered by Regulations 69, Art. 51, or by any other Regulations of which we are aware. The cases cited by petitioner do not touch the question here involved. As the court below observed (R. 18):

> To hold that an amount credited by a taxpayer employing a cash receipts and disbursements method of accounting constitutes a payment, and is, therefore, deductible from gross income in the year in

which credited, would destroy the distinction between the accrual and the receipts and disbursements methods of accounting which is recognized and made controlling by the revenue statutes.

CONCLUSION

The decision below is correct. There is no conflict of authority. The petition should be denied.

Respectfully submitted.

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Sec. 234(a) (2) (U. S. C., Title 26, sec. 986)	14
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Sec. 234(a) (2) (U. S. C. App., Title 26, sec. 986)	14
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Revenue Act of 1928, c. 852, 45 Stat. 791, 842, sec. 203(a) (8) (U. S. C. Sup. V, Title 26, sec. 2203)	10
Revenue Act of 1932, c. 209, 47 Stat. 169, 224, sec. 203(a) (8)	10
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In the Supreme Court of the United States

OCTOBER TERM, 1932

No. 322

THE MASSACHUSETTS MUTUAL LIFE INSURANCE Company, petitioner

v.

THE UNITED STATES

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

OPINION BELOW

The opinion of the Court of Claims (R. 16) is reported in 59 F. (2d) 116.

JURISDICTION

The judgment of the court below was entered May 31, 1932. (R. 19.) Petition for a writ of certiorari was filed August 26, 1932, and granted November 7, 1932. (R. 21.) The jurisdiction of this Court rests upon Section 3 (b) of the Act of February 13, 1925.

QUESTION PRESENTED

Whether the petitioner, a life insurance company making its return upon the basis of actual receipts and disbursements, is entitled to deduct from its gross income for 1926, as interest paid, the amount of interest credited by it to its policyholders during 1926 but not withdrawn by them.

STATUTES AND REGULATIONS INVOLVED

Section 245 of the Revenue Act of 1926, c. 27, 44 Stat. 9, 47 (U. S. C. App., Title 26, Sec. 1004), provides in part:

> SEC. 245 (a) In the case of a life insurance company the term "net income" means the gross income less—
>
> * * * * *
>
> (8) All interest paid or accrued within the taxable year on its indebtedness * * *

Article 685 of Treasury Regulations 69, promulgated under the Revenue Act of 1926, provides in part:

> (3) The deduction allowed by section 245 (a) (8) for interest on indebtedness is the same as that allowed other corporations by section 234 (a) (2) (see articles 561 and 121), but this deduction includes item 18 of the disbursement page of the annual statement of life companies to the extent that interest on dividends held on deposit and surrendered during the taxable year is included therein. Dividends left with the company to accumulate at interest are a debt and not a reserve liability.

STATEMENT

The findings of fact made by the Court of Claims (R. 11–15) may be summarized as follows:

Petitioner, a Massachusetts corporation, is a life insurance company selling insurance on the mutual level premium plan. (R. 11.) Its plan of operation contemplates the return to its policyholders, in the form of "dividends," of a portion of its receipts. Its policies provide that the dividends, when declared, may be withdrawn in cash, applied in various ways as premium payments, or allowed to remain on deposit with petitioner. (R. 15.) If the policyholder adopts the last course, the dividends accumulate at interest, which is added at the end of each policy year. The dividends and accrued interest may be withdrawn by the policyholder on demand. (R. 11, 15.) During 1926, the taxable year now in question, for which petitioner filed its income tax on the basis of actual receipts and disbursements, $544,964.40 became due the policyholders as interest on their dividends left with petitioner. (R. 11, 13.) This amount was credited to the individual accounts of the policyholders during 1926 and was subject to withdrawal on demand. The amount of interest actually withdrawn during 1926, however, was only $248,405.97, the major portion of which did not accrue in 1926. (R. 13.) In its income tax return for 1926 petitioner sought to deduct as interest paid during that year the total amount, $544,964.40, credited to the policyholders' accounts, although less than half that

sum, namely, $248,405.97, had been actually paid out. (R. 11.) The Commissioner disallowed the deduction claimed by petitioner, and instead allowed a deduction only of the interest withdrawn by the policyholders. (R. 13.) Petitioner paid the additional tax resulting from the Commissioner's determination of its net income, duly filed its claim for refund (R. 13), and brought this suit to recover the additional tax. The Court of Claims dismissed its petition. (R. 19.)

SUMMARY OF ARGUMENT

Petitioner, like all other life insurance companies, makes its returns on the cash receipts and disbursements basis. The mere accrual of liability to policyholders for interest on dividends not withdrawn in no way affected the cash position of the petitioner. Taxpayers who make their returns on the cash receipts and disbursements basis are not entitled to deduct accrued liabilities, but only actual disbursements. The scheme of income taxation requires consistency in the basis of return, and the Revenue Acts do not contemplate the return of income by any taxpayer, partly on a cash receipts and disbursements basis and partly on an accrual basis.

No departure from the general scheme of taxation was intended by the provisions of Section 245(a)(8) of the Revenue Act of 1926, upon which the petitioner relies. The statute has been consistently construed by the administrative officers as

permitting the deduction only of interest paid. The administrative construction accords with the practice uniformly followed by all life insurance companies in making their returns and in their annual statements. It is reasonable, consistent with the general scheme of taxation, and should therefore be accepted.

There is nothing in the legislative history of Section 245 (a) (8) to indicate that Congress intended the construction for which petitioner contends. Acceptance of that construction is quite inconsistent with the whole scheme of the Revenue Act, and with the practice of petitioner and all other life insurance companies. The words "paid or accrued" have a settled usage in the Revenue Act and are disjunctive in their application. A taxpayer making his return upon the cash basis may deduct interest "paid." A taxpayer making his return on the accrual basis may deduct interest "accrued." As the petitioner kept its books and made its return on a cash receipts and disbursements basis, it is not entitled to deduct interest accrued.

The doctrine of constructive receipt of income applicable to recipients under regulations and decisions has no application here. There is no similar doctrine of constructive payment.

ARGUMENT

Petitioner, like all other life insurance companies, makes its income tax returns on the cash

receipts and disbursements basis.[1] Petitioner claimed the right to deduct upon its 1926 return $544,964.40 credited to its policyholders as interest on dividends left on deposit with petitioner, subject to their withdrawal on demand, but not actually withdrawn. In that year it had paid out in cash to its policyholders, as interest on dividends, a total of $248,405.97. This sum was allowed by the Commissioner as a deduction from gross income for 1926 and the interest accrued was disallowed. Petitioner now treats the allowance by the Commissioner as a partial allowance of the deduction claimed. When petitioner credited $544,964.40 to policyholders in 1926, it merely became indebted to them to that extent without in any way affecting its previous control of its funds. Petitioner's cash position was unaltered. Petitioner, however, contends that it is entitled to deduct from its gross income for 1926 the amount so credited to its policyholders, although, concededly, the interest was not paid in 1926.

---

[1] *Bulletin H, Income Tax Rulings Peculiar to Life Insurance Companies*, published April 9, 1921:

"1. *Basis of Returns.*—Returns of life insurance companies shall be made on a receipts and disbursements basis, as distinguished from an accrual basis, as being in accordance with the method of accounting regularly employed by such companies * * *."

I

WHERE TAXPAYERS KEEP THEIR BOOKS ON THE CASH BASIS, NO DEDUCTION MAY BE ALLOWED ON ACCOUNT OF OBLIGATIONS WHICH HAVE ACCRUED BUT HAVE NOT BEEN PAID DURING THE TAXABLE YEAR

Income-tax returns of taxpayers generally must be made on the basis which most truly reflects their net income. See *American National Co.* v. *United States,* 274 U. S. 99, 105; *United States* v. *Anderson,* 269 U. S. 422. Where the returns are made on the cash basis, as here, deductions from gross income may be taken only where actual disbursements have been made.

In *Hart* v. *Commissioner,* 54 F. (2d) 848 (C. C. A. 1st), the taxpayer kept his books on the cash basis. During the taxable year in question, being indebted to a bank in a large amount, he "paid" the interest on his loan by giving his personal note for the sum due. The Commissioner refused to allow a deduction of the amount so "paid." The court, upholding the Commissioner, said (p. 852):

> If the note is never paid, the taxpayer has parted with nothing more than his promise to pay. A promise to pay is not cash, and a deduction from interest [income?] is permissible only in the taxable year in which the taxpayer pays cash. * * *

Here, as in that case, the taxpayer has done no more than promise to pay in the future; in the

meantime it still has full control of its funds, which it can invest and on which it can continue to receive a return. See also *Eckert* v. *Burnet*, 283 U. S. 140, 141–142.

In *United States* v. *Mitchell*, 271 U. S. 9, which held that a taxpayer on a cash basis could not deduct from his gross income Federal estate taxes which accrued but were not paid during the taxable year, this Court said (p. 12):

> It was not the purpose of the Act to permit gross income actually received to be diminished by taxes *or other deductible items* disbursed in a later year, even if accrued in the taxable year. It is a reasonable construction of the law that the same method be applied to both sides of the account. (Italics ours.)

See also *Appeal of Reubel*, 1 B. T. A. 676.

The Board of Tax Appeals has consistently held that taxpayers making their returns on a cash receipts basis may not deduct interest which became due but was not actually paid within the taxable year. See *Appeal of Seaboard Oil Co.*, 1 B. T. A. 1259; *Appeal of Utah Orpheum Co.*, 3 B. T. A. 1041; *Appeal of Georgia State Savings Association*, 4 B. T. A. 748; *The Barto Co.* v. *Commissioner*, 21 B. T. A. 1197. See also *de Paoli* v. *Commissioner*, 8 B. T. A. 294; *Warrick* v. *Commissioner*, 20 B. T. A. 220; *Colvert* v. *Commissioner*, 6 B. T. A. 623; *Mann* v. *Commissioner*, 59 App. D. C. 103.

II

LIFE INSURANCE COMPANIES ARE NOT AUTHORIZED TO DEDUCT INTEREST DUE TO THEIR POLICYHOLDERS, UNLESS ACTUALLY PAID

The principles applicable to other taxpayers keeping their books and making their returns on the cash receipts and disbursements basis, adverted to above, apply equally to life insurance companies. Other taxpayers are not permitted to combine the cash and accrual bases in their returns, and in the absence of a clear declaration of legislative purpose it is not to be supposed that Congress intended life insurance companies to depart from settled principles necessarily applicable to the computation of all income taxes. Apparently conceding that all other taxpayers are required to maintain consistency in their returns, petitioner seeks the right to make a novel hybrid return because of the provision in Section 245 (a)(8) of the Revenue Act of 1926, *supra,* that a life insurance company may deduct from its gross income "all interest paid *or accrued* within the taxable year on its indebtedness." (Italics ours.)

The provision of the 1926 Act now involved first appeared as Section 245(a)(8) of the Act of 1921, c. 136, 42 Stat. 227, 261. This section was reenacted as Section 245(a)(8) of the Act of 1924, c. 234, 43 Stat. 253, 289 (U. S. C., Title 26, Sec. 1004). No change was made in the section when it was reenacted as Section 245(a)(8) of the 1926 Act, *supra.*

It has been reenacted in the same form as Section 203(a)(8) in the Revenue Act of 1928, c. 852, 45 Stat. 791, 842, (U. S. C. Sup. V, Title 26, Sec. 2203), and Section 203(a)(8) of the Revenue Act of 1932, c. 209, 47 Stat. 169, 224.

Treasury Regulations 62, Art. 685(3), applicable to Section 245 (a) (8) of the 1921 Act, provided in effect that the interest payable by insurance companies on dividends which may be deducted is the amount paid out during the taxable year. The regulations state that the deduction for interest on indebtedness "includes item 18 of the disbursement page of the annual statement of life companies * * *."[2] Item 18 is "Dividends and interest thereon surrendered during the year."[3] In the instant case the Commissioner allowed as a deduction the amount shown on item 18 of petitioner's annual statement. The only interest included in this item was "surren-

[2] The annual statement of life insurance companies is a standard form used by all life insurance companies in the United States and prescribed by the National Convention of Insurance Commissioners. (See Section 246 (b) (1), Revenue Act of 1926.) The annual statement is so drawn that the report of a particular company will necessarily be strictly on the cash receipts and disbursements basis.

[3] While the standard form of annual statement is revised from time to time by the commissioners, we are informed that item 18 remained unchanged from the time of promulgation of Regulations 62 through the taxable period involved herein.

dered," that is, paid during the taxable year. (R. 13.)[4]

This regulation was carried forward to the regulations applicable to the 1924 Act, Regulations 65, Art. 685(3), and to Regulations 69, Art. 685(3), applicable to the 1926 Act. Throughout this period the statute remained unchanged.

The administrative construction thus adopted consistently construed the statutory provision in a manner which harmonized with the method of making returns and annual statements followed by all life insurance companies.[5] Such consistent administrative construction was therefore obviously reasonable and is entitled to great weight. See *Murphy Oil Co.* v. *Burnet*, decided December

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[4] Item 18 in the disbursement page of the annual statement of the petitioner for the year 1926 reads as follows:

"18. Dividends $1,767,501.89 and interest $248,405.97 thereon held on deposit surrendered during the year—$2,015,907.86."

The sum which the petitioner desires to deduct appears in its annual statement for 1926 on p. 5, under the heading "Liabilities, Surplus, and Other Funds," as follows:

"22. Dividends left with the company to accumulate at interest, and accrued interest thereon, *including $544,967.40, interest credited during the year and payable on demand* $14,000,669.68." (R. 13.)

[5] We are informed that life insurance companies have without exception made their tax returns on the cash basis since the corporation excise tax provisions of the Tariff Act of 1909, c. 6, 36 Stat. 11, 112, Sec. 38.

5, 1932 (No. 80, October Term, 1932); *Interstate Commerce Commission* v. *New York, New Haven & Hartford Railroad Company,* decided November 21, 1932 (No. 15, October Term, 1932); *McCaughn* v. *Hershey Chocolate Company,* 283 U. S. 488, 492; *Fawcus Machine Co.* v. *United States,* 282 U. S. 375, 378; *Brewster* v. *Gage,* 280 U. S. 327, 336.

Petitioner contends that the administrative construction must be disregarded because it virtually eliminates the words "or accrued" from the provisions of Section 245 (a) (8) and thus is an attempt to abridge statutory provisions which petitioner asserts are plain and unambiguous and require no construction.

It is true that the words "or accrued" can have no application to companies which keep their books upon a cash basis, and it is also true that all life insurance companies do keep their books on this basis. These companies are not, however, required to do so by the statute, and their practice, even when sanctioned by regulation and made the basis of their tax returns, can not change the meaning of the words "paid or accrued," which in their application to taxpayers generally are understood to mean that interest "paid," by taxpayers whose income is returned on a cash basis, "or accrued" on the books of taxpayers whose income is returned on an accrual basis, shall be deducted from gross income. This interpretation is in harmony with the scheme and purpose of the law, the practice of taxpayers

and the administrative rulings which have received legislative approval.[6]

The genesis of Section 245 (a) (8) indicates that the words "or accrued" were incorporated without reference to the practice of life insurance companies in making their returns on the cash basis. Before the Act of 1921 there were no separate provisions applicable to life insurance companies covering the deductions involved in this case. The general provision which applied to all corporations, including life insurance companies, contained only the word "paid," until the Act of 1918, in which the words "or accrued" were added. The Tariff Act of 1913, Sec. II–G (b), c. 16, 38 Stat. 114, 172; Revenue Act of 1916, Section 12 (a) (3), c. 463, 39 Stat. 756, 768; Revenue Act of 1917, Section 1207 (1), c. 63, 40 Stat. 300, 334; Revenue Act of 1918, Section 234 (a) (2), c. 18, 40 Stat. 1057, 1077.

Treasury Regulations applicable to the Act of 1916 provided that the word "paid" was to be construed in accordance with the method of accounting adopted by the taxpayer. See Regulations 33 (1918 ed.), Arts. 126, 180. Thus, under

[6] It is to be noted that, considering the tax liability over a period of future years, it makes no practical difference in tax whether interest paid or accrued is allowed as a deduction, for all interest accrued will eventually be deductible as interest paid. But it is probable that the allowance of interest accrued in a particular year would require readjustment of tax liability for earlier years, and if a larger tax liability for earlier years was disclosed, the statute of limitations might bar collection.

that Act a corporation making return on a cash basis could not deduct interest on indebtedness which accrued but was not paid during the taxable year, while a taxpayer allowed by the Commissioner to make return on an accrual basis (after the Revenue Act of 1916) could deduct interest accrued. The addition of the words "or accrued" in the Act of 1918 did not change the meaning of the section. The word "paid" retained its previous construction (Regulations 45, Arts. 23, 1533), and a corporation's privilege to deduct interest on its indebtedness depending upon its method of accounting remained precisely the same as under the earlier Acts. *Appeal of Seaboard Oil Co.*, 1 B. T. A. 1259. When in 1921 insurance companies were for the first time treated separately, the section permitting deduction of interest was simply copied directly from the similar section applicable generally to corporations. See Revenue Act of 1921, Sec. 234 (a) (2), c. 136, 42 Stat. 227, 254; Revenue Act of 1924, Sec. 234 (a) (2), c. 234, 43 Stat. 253, 283; Revenue Act of 1926, Sec. 234 (a) (2), c. 27, 44 Stat 9. 41. The presumption is that the words had precisely the same meaning in their new setting as they had in their old even though because of accounting practices then in vogue there were no life insurance companies on the accrual basis. If it was the purpose of Congress to engraft on a familiar method of making returns long followed by all life insurance companies, a novel and exotic provision having no relation to the method of re-

turn or of rendering their annual statements, it would be natural to find some consideration of the subject in the Committee Reports, but there is none.

The words "paid or accrued" are disjunctive in their application to two kinds of tax returns—those made upon the cash basis, and those made upon the accrual basis. If return is made upon the cash basis, interest "paid" may be deducted; if upon the accrual basis, interest "accrued" may be deducted. See *United States* v. *Anderson,* 269 U. S. 422, 438–440; *Appeal of Reubel,* 1 B. T. A. 676, 678. The words "or accrued" are not applicable to the petitioner because under the rulings of the Treasury Department and the consistent practice of all life insurance companies which they approve, the cash receipts and disbursement method of accounting is followed by it. In the case of ordinary corporations under Section 234 (a) (2) of the 1926 Act, *supra,* the word "paid" has no application when a corporation makes return on the accrual basis. See *Miller & Vidor Lumber Co.* v. *Commissioner,* 39 F. (2d) 890 (C. C. A. 5th); *United States* v. *Anderson, supra; Appeal of Atlantic Coast Line R. R. Co.,* 2 B. T. A. 892. And the words "or accrued" are likewise inapplicable if the taxpayer makes return on the cash basis. See *United States* v. *Mitchell, supra; Hart* v. *Commissioner, supra.* Similarly, the petitioner, not being on the accrual basis, may deduct interest paid and may not deduct interest accrued.

The result for which petitioner contends requires distortion of the scheme of income taxation applied to all taxpayers. Unless no other result can properly be reached, the statute should not be construed to permit one class of taxpayers, in this respect no different from any other, to return only the gross income actually received during the taxable year and to deduct from that sum not only current expenditures but also payments that are merely anticipated. As the court below observed (R. 18):

> To hold that an amount credited by a taxpayer employing a cash receipts and disbursements method of accounting constitutes a payment, and is, therefore, deductible from gross income in the year in which credited, would destroy the distinction between the accrual and the receipts and disbursements methods of accounting which is recognized and made controlling by the revenue statutes.

III

THE DOCTRINE OF "CONSTRUCTIVE RECEIPT" OF INCOME IS INAPPLICABLE

Petitioner contends that in any event the interest was "constructively paid" during 1926, since, by Regulations 69, Article 51—

> Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. * * *

A number of cases support the regulations and show that taxpayers, even though they keep their books on the cash receipts basis, may "constructively receive" income which has been credited or set apart for them, although not actually taken in cash at the time. See *Hadley* v. *Commissioner*, 36 F. (2d) 543 (App. D C.); *Chipley* v. *Commissioner*, 25 B. T. A. 1103; *Appeal of Brander*, 3 B. T. A. 231; cf. *Commissioner* v. *Bingham*, 35 F. (2d) 503 (C. C. A. 6th), certiorari denied, 281 U. S. 729. But these cases, like the regulations to which they give effect, relate to the taxability of the potential recipient and depend upon the circumstance that funds are subject to the demand of the taxpayer and consequently may be brought under his possession and control at his will. The purpose of the regulations was clearly to prevent evasion or postponement of taxes by one who was entitled to exercise dominion over a fund. But no such purpose could be served by a doctrine of "constructive payment" by a taxpayer. It is for this that petitioner apparently contends. There are no regulations or decisions of which we are aware which establish a rule of constructive payment.

Article 685 (3) of Regulations 69, specifically covers the deductions allowed by Section 245 (a) (8). The statute and the regulations are clear and unmodified by any rule of constructive payment. Such a rule would seem to require a departure from petitioner's method of return. The National Convention of Insurance Commissioners appar-

ently has never recognized it in prescribing the form of annual statement and apparently it has never been applied to the returns of life insurance companies either by taxpayers or the Commissioner.

CONCLUSION

The judgment of the Court of Claims is correct and should be affirmed.

Respectfully submitted.

THOMAS D. THACHER,
Solicitor General.

CHARLES B. RUGG,
Assistant Attorney General.

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Special Assistant to the Attorney General.

WALTER GELLHORN,
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DECEMBER, 1932.

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CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

October Term, 1932.
No. 322.

THE MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY,
(A Corporation), Petitioner

vs.

THE UNITED STATES.

PETITION OF PETITIONER FOR RE-HEARING.

GUY PATTEN,
A. R. SERVEN,
Counsel for Petitioner.

PRESS OF THE SUDWARTH COMPANY, WASHINGTON

Supreme Court of the United States

October Term, 1932.

No. 322.

THE MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY,
(A Corporation), Petitioner

vs.

THE UNITED STATES.

PETITION FOR RE-HEARING.

Comes now the above named petitioner, the Massachusetts Mutual Life Insurance Company, and presents this, its petition for a re-hearing of the above entitled cause, and, in support thereof, respectfully shows:

That the opinion of this Honorable Court in this cause was rendered on February 6, 1933.

That this Honorable Court, upon the first issue, having held that petitioner is required to make its income tax returns upon the cash receipts and disbursements method of accounting and is therefor entitled to only such deduction for interest paid as other taxpayers similarly situated, there remained the question, whether, the petitioner is entitled to the deduction from gross income of all

interest unconditionally credited to its policyholders during the taxable year subject to withdrawal on demand, as interest "paid." Upon this issue, in considering the application of Article 51 of Regulations 69, which provides:

> "Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession,"

this Honorable Court reached the conclusion from the information before it that—

> "This regulation has, however, not been applied in any case where income has been credited to another by a taxpayer employing the cash receipts and disbursements method of accounting; and specifically it has not been invoked to require policyholders to report as income the dividends or interest credited to them in cases such as this. No tax is demanded of them until actual receipt of the money. The constructive payment theory is, we think, untenable."

This case was heard by this Honorable Court on January 16th and 17th, 1933. At that time it was impossible for the petitioner to aid the court in the matter of information relative to the administrative application of the law and said regulation to the facts in the cases such as this, because such information is only available to petitioner through the published rulings and decisions of the Bureau of Internal Revenue. No such ruling or decision, so far as known to petitioner, had ever been published at the time this case was heard.

However, since the trial of this case an opinion of the General Counsel, Bureau of Internal Revenue, has been published in the Internal Revenue Bulletin of January 30, 1933, Vol. XII, No. 5, at Page 1, which opinion relates to the application of Article 322 of Regulations 74 under the Revenue Act of 1928. The provision of the regulation is: "*A taxpayer is deemed to have received items of gross income which have been credited or set apart for him without restriction.*" (Italics ours). The opinion holds that a taxpayer, which keeps its books on the cash receipts and disbursements basis, may deduct the amount of interest actually credited to the accounts of its depositors and the depositors must report such interest as income. Said opinion is set forth in full at Page 9 of the Appendix hereto. Attention is respectfully called to that part of the opinion (Appen. p. 11) in which the case at bar, as decided by the Court of Claims, is contrasted. We feel it is apparent that the General Counsel in making such comparisons fell into error with reference to the provisions of the policy contracts under which (Fdg. 8, R. 14-15) the dividends are held by the company to accumulate at interest only in the event the policyholder either so elects or the account is thus settled by his failure to withdraw them in cash or otherwise use them. This constitutes the settlement. Thereafter they are subject to the disposition of the policyholder and not the company. In the paragraph following wherein the General Counsel says—

> "In the case of bank accounts, such as those involved in the instant case, the crediting of interest to the account of the depositor and the striking of a new balance upon which in-

> terest thereafter is computed constitutes, in the opinion of this office, a result that must be regarded as conclusive, since the account can not be reopened by a party seeking a different result except by mutual agreement or by clear and satisfactory evidence of error, fraud, or mistake;"

he states a set of facts exactly parallel to the facts in the case at bar. In the instant case, when interest on dividends left is credited to the policyholder, instead of being withdrawn by him in cash or otherwise applied, it immediately becomes a part of the fund upon which interest thereafter is computed.

Your petitioner further shows that since this case was tried before this Honorable Court the Commissioner of Internal Revenue on January 27, 1933, in a ruling made by him held that when the amount called for by a policy of life insurance, under an option therein, is left with the company at interest "The amount thereon credited to the beneficiary as interest constitutes taxable income to the beneficiary for the year in which it is credited, inasmuch as such interest is subject to his demand." This ruling it appears reaffirms a ruling to the same effect made as early as November 10, 1927. The aforesaid ruling was published in the Prentice-Hall Federal Tax Service, in its issue of February 9, 1933, Vol. 1, Page 17. Said ruling is set forth in full in the Appendix hereto at page 13. It would seem there can be no difference in principle between the character of interest on amounts called for by a policy of life insurance which are left by the beneficiary with the company at interest, and interest on dividends called for by such a policy which are left with the com-

pany by the insured at interest, because in neither case is the interest exempt from taxation. It is only the dividends (which represent a return of premiums), or other amounts called for by the policy, as pointed out by the Commissioner of Internal Revenue in the above opinion, that the statute exempts. Both are in accord with Article 47 of Regulations 69 under the Revenue Act of 1926, which provides:

> "Amounts received by an insured as a return of premiums paid by him under life insurance, endowment, or annuity contracts, such as the so-called "dividends" of a mutual insurance company which may be credited against the current premium, are not subject to tax."

It is unfortunate that petitioner was unable to give the court the benefit of the aforesaid rulings at the time this case was tried, as it is believed if the court had been fully so advised its conclusion upon this question might have been different.

For the foregoing reasons, it is respectfully urged that this petition for a re-hearing be granted, and that the judgment of the Court of Claims be, upon further consideration, reversed.

Respectfully submitted,

GUY PATTEN,
A. R. SERVEN,
Counsel for Petitioner.

Certificate of Counsel.

I, Guy Patten, Counsel for the above named petitioner, do hereby certify that the foregoing petition for a re-hearing of this cause is presented in good faith and not for delay.

GUY PATTEN,
Counsel for Petitioner.

APPENDIX.

Revenue Act of 1928.

SECTION 42.—PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

XII-5-6008.
G. C. M. 11348.

Article 332: Income not reduced to possession.

REVENUE ACT OF 1928.

> Where a bank, which keeps its books on the cash receipts and disbursements basis, sets up a reserve each month for the estimated amount of interest due on savings accounts, known as "time deposits," the accrual of interest in the so-called reserve account does not constitute such interest a deductible item. The bank may deduct only the amount of interest actually credited to the accounts of its time depositors, and the depositors must report such interest as income.

An opinion is requested relative to the application of the provisions of Article 332 of Regulations 74 in determining the amount of interest which may be deducted from the gross income of the M Company in connection with a proposed deficiency against the taxpayer for the year 1930.

The facts as set forth in the taxpayer's protest are as follows:

> This taxpayer is in the banking business at the city of X, State of Y, and has on deposit various sums in savings accounts, otherwise known as "time deposits." During the year 1930 these savings accounts were about x dollars. Interest was payable upon these accounts during this year at the rate of 4 per cent per year. At the end of each calendar

month the bank set up as a reserve the estimated amount of interest due on these accounts for that month. Once each six months the amount of interest due upon each individual account was entered as a credit to that individual account, and charged against the reserve theretofore set up. Up to and including the year 1929 these entries to the individual accounts had been made June 30 and December 31. In 1930 entries were made to the individual accounts for three months on April 1, 1930, and for six months' interest on October 1, 1930.

This interest is not paid out to the individual depositors, except at such time as they call for and withdraw their savings accounts. When such call is made, the depositor is paid the full amount of the interest up to the date of withdrawal, whether such date be on a day when credit is regularly made to his account (which would be a rare coincidence) or otherwise. The handling of the interest is altogether a matter of bookkeeping entries.

Taxpayer's returns were upon a cash receipts and disbursements basis. On its return for the year 1930 taxpayer deucted interest for 12 months on these saving accounts. * * *

The taxpayer states that at the end of each month a bookkeeping entry is made setting up accrued interest in a reserve account. Twice each year another bookkeeping entry is made setting up the interest in the account of the individual depositor. According to the taxpayer's brief, "He (the depositor) may come in any day that he pleases (after furnishing the requisite notice, if

his deposit is a time deposit) and interest up to that day is subject to his withdrawal, no matter what day it happens to be."

The opinion of this office is requested relative to the application of the decision of the Court of Claims in the case of the *Massachusetts Mutual Life Insurance Co.* v. *United States* (59 F. (2d), 116, Ct. D. 563, Bulletin XI-38, 14) to the instant case, with specific reference to the following questions:

> (a) Whether the taxpayer is entitled to deduct from its gross income the total amount of interest actually credited to the accounts of its time depositors during the year 1930;
>
> (b) If the preceding question is answered in the negative, when is such interest deductible from the gross income of the taxpayer; and
>
> (c) If the answer to the first question is in the negative when are the time depositors required to report in gross income the interest credited to their accounts.

In the case of *Massachusetts Mutual Life Insurance Co.* v. *United States*, supra, it was held that a life insurance company, required by law and regulations to use the cash basis of accounting as distinguished from the accrual basis, may not deduct in 1926 interest credited to its policyholders in 1926 under the terms in the policies, although the policy contracts provided that the interest was subject to withdrawal on demand, and the policyholders were notified during the year of the amount of interest so credited. In its opinion the Court of Claims used the following language:

> Other than in the administration of es-

> tates or trusts, as to which the statute specifically provides for a deduction of credits under certain circumstances, we know of no instance, and none has been cal ed to our attention, in which it has been held that an amount credited but not paid by a taxpayer employing the cash receipts and disbursements method of accounting constitutes income to the person to whom credited. It is not claimed that the interest credited by the plaintiff to its stockholders during 1926 was taxed as income to them in that year by the Commissioner. To hold that an amount credited by a taxpayer employing a cash receipts and disbursements method of accounting constitutes a payment, and is therefore deductible from gross income in the year in which credited, would destroy the distinction between the accrual and the receipts and disbursements methods of accounting which is recognized and made controlling by the revenue statutes. * * *

It is clear that the accrual of interest in the so-called reserve account does not constitute such interest a deductible item in the case of a taxpayer whose books of account are kept on the cash receipts and disbursements basis. Here the only question to be determined is the status of the interest actually credited to the accounts of depositors, *i.e.*, whether the interest so credited may be considered as interest paid within the taxable year. It appears that the interest is credited on the depositors' accounts twice annually, at specified dates, instead of being paid in cash or by check, pursuant to an understanding or agreement between the bank and the depositors; and that the amount of the interest so credited be-

comes a part of the principal sum and bears interest from the date of the credit.

In banking the general rule in keeping the account of a depositor is that as money is paid in and drawn out a balance may be considered as struck at the date of each payment or entry, on either side of the account. *(Wasson* v. *Lamb,* 22 N. E. 729). It is, of course, necessary that the bank should keep a correct entry in its books. Frequently depositors make use of what is known as the "pass book," in which entries are made corresponding to the entries made in the depositor's account on the books of the bank, and a balance is struck. From the entries thus made by the banker, the depositor is apprised of the state of his account. Such entry in the pass book is in effect an account stated between the bank and its depositor. *(Greenhalgh Co.* v. *Farmers' National Bank,* 226 Pa., 184, 134 Am. S. R. 1016, 75 Atl., 260). In a note on this subject appearing in 134 Am. S. R., 1022, the law is stated as follows:

> * * * Entries in a depositor's pass book striking a balance coupled with the delivery of the book to him, without objection on his part, constitute an account stated. *(Clark v. Mechanics' National Bank,* 11 Daly, 239; *August v. New York Fourth National Bank,* 1 N. Y. Supp., 139; *Leather Manufacturers' National Bank v. Morgan,* 117 U. S. 96, 6 Sup. Ct. Rep. 657, 29 L. Ed. 811.) And the proposition stands even on a firmer base, if, as is often done, the bank has returned to the customer his checks with the account of the balance. * * * *The mere fact that the account contains interest charges for which, of course, no checks have been drawn, does not impair the status of the account. (Schoonover*

v. Osborne, 108 Iowa, 453, 79 N. W., 263). (Italics supplied).

In the Massachusetts Mutual Life Insurance Co. case, supra, the amounts credited to the policyholder's account do not become income to him until he elects to exercise the option afforded under the policy contract of taking the same in cash, rather than to permit it to remain subject to the disposition of the company under the terms of the policy contract.

In the case of bank accounts, such as those involved in the instant case, the crediting of interest to the account of the depositor and the striking of a new balance upon which interest thereafter is computed constitutes, in the opinion of this office, a result that must be regarded as conclusive, since the account can not be reopened by a party seeking a different result except by mutual agreement or by clear and satisfactory evidence of error, fraud, or mistake. *(See Chappedelaine* v. *Dechenaux*, 4 Cranch, 306, and other cases cited therein).

The crediting of interest to policyholders on the books of an insurance company in no sense presents a situation parallel to that under consideration in the instant case where a bank by crediting interest on certain agreed due dates to the accounts of its depositors, in effect "deposits" the amount of the interest to such accounts. It would seem, on the contrary, that the credits involved in the instant case, constitute, both for legal and practical purposes, that kind of deposit, peculiar to the banking business, in which the depositor, for his own convenience, parts with the title to his money and loans it to the banker; and the latter, in consideration of the loan of the money and the

right to use it for his own profit, agrees to refund the same amount or any part thereof, on demand. (See *Marine Bank* v. *Fulton Bank*, 2 Wall. (U.S.), 252, 256). The only apparent difference between this and the ordinary deposit is that, by agreement or mutual understanding for the convenience of both parties, the formality of payment by cash or check and the actual deposit thereof by the depositor are dispensed with; and, as stated in 5 Cyc., 517 (IV):

> The law presumes that a deposit belongs to the person in whose name it is entered and the bank can not question his right thereto.
> * * * When money is deposited in a bank it is said to be the debtor and the depositor the creditor. Yet in another sense the depositor is the owner and can at any time demand repayment. * * *

Moreover, the principles of law applicable to deposits, in so far as the status of credits to accounts of bank depositors are concerned for income tax purposes, appear to be the same whether the accounts relate to time deposits, checking, or savings accounts, where the amount of such credits becomes immediately available to the depositor or owner of the account.

Accordingly, it is the conclusion of this office that the taxpayer is entitled to deduct from its gross income only the amount of interest actually credited to the accounts of its time depositors during the year 1930, and the depositors must report such interest as income.

C. M. CHAREST,

General Counsel, Bureau of Internal Revenue.

TREASURY DEPARTMENT
Washington

Office of
Commissioner of Internal Revenue

JANUARY 27, 1933.

Address Reply to
Commissioner of Internal Revenue

Sir:

Reference is made to your letter dated November 9, 1932, furnishing additional information for consideration in connection with your previous request for reconsideration of the Rulings made by Office Letters of November 10, 1927, and February 28, 1928, relative to the status for income tax purposes of the amounts received or to be received upon the death of the insured as the proceeds of insurance policies issued by the * * * Insurance Company in behalf of which the question is presented by you.

Reconsideration of such rulings is requested in view of the ruling made by Office Letter of August 15, 1932, pertaining to the amount payable as the proceeds of the policy designated as the "Family Income Policy—20 Year Period." Under that policy on a $10,000.00 basis the company pays the beneficiary $100.00 a month from the date of death of the insured to the expiration of the period of twenty years from the date on which the policy was issued, and the amount of $10,000.00 is payable in cash at the expiration of such period. Although the amount of $10,000.00 would of course earn income in the hands of the company from the date of the death of the insured to the date of payment to the beneficiary, the withholding of payment of such amount was held to be one of the things contracted for and acquired by the insured

as consideration for the premium payments made as the cost of the policy. While the periodic payments made to the beneficiary would appear to represent in part earnings on the deferred payments, such payments were held to constitute a part of the proceeds of the policy payable by reason of the death of the insured, and the entire amount received or to be received by the beneficiary was held to be exempt from the income tax under Section 22 (b) (1) of the Revenue Act of 1932 and the corresponding sections of the prior acts.

Your present inquiry pertains to a policy calling for the payment of the specified amount or amounts to the designated beneficiary or beneficiaries upon the death of the insured in accordance with one of five optional methods of settlement set out in the policy. The amount of the respective payments to be made is based on each $1,000.00 of insurance carried by the insured at the date of death. If no method of settlement is designated by the insured prior to his death, it appears that such selections as to the various methods may be made by the beneficiary. In such case, however, the principal sum or face amount of the policy is obviously available to the beneficiary upon the death of the insured and such amount constitutes the proceeds of the policy regardless of the arrangement made by the beneficiary as to the method of payment. The question presented therefore pertains to cases where the method of settlement is designated by the insured prior to his death. The five optional methods designated by Numbers 1 to 5 are summarized as follows:

1. The amount called for by the policy is left

with the company subject to withdrawal at any time in sums of not less than $100.00. While so left with the company interest is payable thereon at an annual rate of not less than 3%.

2. Under this option the amount of the proceeds is payable in equal periodic installments over a period not to exceed 30 years.

3. Under this option a monthly of other periodic amount is payable to the beneficiary for life with payment of such amount guaranteed for a specified period not to exceed 20 years.

4. Under this option the amount called for by the policy is held by the company and payments are made to the present or immediate beneficiary at an annual rate of not less than 3% if paid annually or at a slightly lower rate if payments are made at shorter intervals.

5. Under this option the amount called for by the policy is left with the company under an arrangement for payment to be made to the beneficiary in equal periodic installments with provision that the amount payable each year is not to be less than 5% of the amount originally left with the company.

Under options 4 and 5 any amount remaining at the date of death of the beneficiary is payable to his estate unless otherwise agreed to in writing although it appears that any disposition in this respect is required to be made by the insured and not by the beneficiary. It is also to be observed that where settlement is made by deferred payments the total amount payable is in excess of the principal sum or face amount of the policy. Thus under option 2 where payments are to be made over a period of 10 years it is observed that for each $1,000.00 of insurance the total payments

to be received if made annually aggregate $1,138.10.

In reply you are advised that where option 1 is so designated by the insured the amount called for by the policy is subject to withdrawal by the beneficiary although it may be voluntarily left with the company by him. The amount of the proceeds under this option is therefore the amount called for by the policy, and the amount thereon credited to the beneficiary as interest constitutes taxable income to the beneficiary for the year in which it is credited inasmuch as such interest is subject to his demand. The ruling made by Office Letter of November 10, 1927, with respect to settlement made under this option is therefore reaffirmed.

Under the other or remaining four options the method of payment is fixed or designated by the insured prior to his death and is not subject to change by the beneficiary. The principles to be applied with respect to settlement made under these options are therefore those set out in the Ruling published as G. C. M. 10843 in Internal Revenue Bulletin Vol. XI, No. 43, page 2. As therein set out any system of deferred payments ordinarily involves the element of interest. This is of course true in any case where payment is made in installments but regardless of that fact the entire amount payable as the proceeds of the policy where payment is made in installments is exempt from the income tax by the express provisions of the statute.

Under each of these four options where the method of settlement is designated by the insured all amounts received under the method selected are of course received as consideration for the amount of the premium payments as the cost of

the policy. Where such elections or designation is made by the insured all amounts received in settlement upon the death of the insured therefore go to form a part of the amount paid or to be paid by reason of the death of the insured under Section 22 (b) (1) of the Revenue Act of 1932 and the corresponding provisions of the prior Acts. Regardless of whether such payment be made to a single beneficiary, to a first and second beneficiary, or to a beneficiary and his estate, the entire amounts so received are accordingly held to be wholly exempt from the income tax, and the rulings made by Office Letters of November 10, 1927, and February 28, 1928, are modified accordingly.

Respectfully,

(Signed) DAVID BURNET,

Commissioner.

SUPREME COURT OF THE UNITED STATES.

No. 322.—October Term, 1932.

The Massachusetts Mutual Life Insurance Company, Petitioner, *vs.* The United States of America.	On Writ of Certiorari to the Court of Claims.

[February 6, 1933.]

Mr. Justice Roberts delivered the opinion of the Court.

The question in this case is whether the petitioner, a Massachusetts life insurance company operating on the mutual level premium plan, is entitled, under Sec. 245 of the Revenue Act of 1926,[1] to deduct from its gross income, as interest paid, the amount of interest credited to its policyholders during the taxable year, but not withdrawn by them.

Petitioner agrees to repay a portion of its receipts to policyholders in the form of dividends. The policies provide that these dividends, when declared, may at the option of the insured be withdrawn in cash, applied as premium payments, or allowed to remain on deposit with the company at interest. If the last alternative be chosen the dividends and interest accumulate; interest being added to the accumulated sum at the end of each policy year. The dividends and all accrued interest thereon may be withdrawn at any time on demand. Of the total which became due policyholders in 1926 as interest on sums so left with the company, $544,964.40, the portion not withdrawn, was credited in appropriate amounts to the individual accounts of the policyholders during that year. In its tax return the petitioner deducted as interest paid the amount so credited. Interest actually withdrawn during 1926 totaled $248,405.97, some of which was credited to the policyholders in that year, but the greater portion of which had accrued prior to 1926, and had been credited in the respective years of accrual. No deduction was taken for this sum. The Commissioner disallowed

[1] 44 Stat. 9, 47.

the claimed deduction, and allowed in lieu thereof the amount of interest actually withdrawn in 1926. The resulting additional tax was paid under protest, a claim for refund filed, and, the Commissioner having failed to act upon the claim, suit was brought in the Court of Claims to recover the amount. That court dismissed the petition[2] and we brought the case here by certiorari.

The earlier Revenue Acts made no distinction, in the method of computing the tax, between insurance companies and other corporations. The Act of 1921 and those subsequently adopted embodied special and separate provisions respecting such companies.[3] In the Act of 1926, with which we are here concerned, the applicable sections are 242 to 247, inclusive, the first four dealing with life companies. Section 244 defines gross income as the amount received during the taxable year from interest, dividends and rents. Section 245 defines net income as the gross income, less certain enumerated deductions. Paragraph (8) permits deduction of: "All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities . . . the interest upon which is wholly exempt from taxation under this title".

The language of paragraph (8) with respect to interest paid or accrued on indebtedness is precisely the same as that employed with respect to deductions allowed to individuals by section 214 (a) (2)[4] and to corporations by Section 234 (a) (2).[5] Section 200 (d)[6] enacts that "The terms 'paid or incurred' and 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the net income is computed under Section 212 or 232". . . . The sections mentioned are those applicable to individuals and to corporations generally; neither deals with insurance companies, which, as above said, are treated exclusively in Sections 242 to 247, inclusive.

[2] —— C. Cls. ——.

[3] Rev. Act 1921, §§ 242-247, 42 Stat. 261; Rev. Act 1924, §§ 242-247, 43 Stat. 288; Rev. Act 1926, §§ 242-247, 44 Stat. 47; Rev. Act. 1928, §§ 201-205, 45 Stat. 842; Rev. Act 1932, §§ 201-205, 47 Stat. 223.

[4] 44 Stat. 26.

[5] *Ibid.*, 41.

[6] *Ibid.*, 10.

In the light of these provisions the petitioner insists that insurance companies are forbidden by the terms of the statute to keep their accounts and make their returns by the accrual method, but must report on the cash basis. Hence it is claimed the words "paid or accrued", as applied to interest, cannot grant an option in the matter of returns, depending upon whether the insurance company keeps its accounts on a cash basis or on an accrual basis, as in the case of other taxpayers, since the company has no choice in this respect; that the word "accrued" cannot be read out of the statute or left without meaning or effect; and that the phrase is employed to describe and allow deduction of interest accrued on dividends left with the company.

The Government replies that prior to 1921 there was no statutory direction as to how insurance companies' returns should be made; a regulation required them to be upon the cash basis; when new sections were inserted in the Act of 1921 as to insurance companies the phraseology with respect to interest deductions of individuals and corporations generally was lifted bodily out of the sections applicable to individuals and corporations and inserted in these new sections; as the act does not permit insurance companies to account on the accrual basis, only interest paid is deductible, and the term "accrued" has no application. It further points to a regulation adopted immediately upon the passage of the Act of 1921 and carried forward in the regulations under the Acts of 1924 and 1926. This regulation is:[7]

"The deduction allowed by section 245 (a) (8) for interest on indebtedness is the same as that allowed other corporations by section 234 (a) (2) (see articles 561 and 121), but this deduction includes item 18 of the disbursement page of the annual statement of life companies to the extent that interest on dividends held on deposit and surrendered during the taxable year is included therein".

Item 18 of the disbursement page of the annual statement of insurance companies includes the amount of interest actually paid policyholders, whereas accrued interest credited and not withdrawn is shown in item 22 on page 5 of the standard form of report. Insurance companies have without exception complied with the

[7] Treasury Regulations 62, Art. 685 (3). See Regulations 65, Art. 685(3); Regulations 69, Art. 685(3).

regulation and taken a deduction only for interest paid. The right to deduct interest credited to policyholders but not withdrawn is now asserted for the first time.

The Congress in the Revenue Acts of 1928 and 1932 reenacted Section 245 without alteration.[8] This action was taken with knowledge of the construction placed upon the section by the official charged with its administration. If the legislative body had considered the Treasury interpretation erroneous it would have amended the section. Its failure so to do requires the conclusion that the regulation was not inconsistent with the intent of the statute (*National Lead Co.* v. *United States,* 252 U. S. 140, 146; *Poe* v. *Seaborn,* 282 U. S. 101, 116; *McCaughn* v. *Hershey Chocolate Co.,* 283 U. S. 488, 492; *Costanzo* v. *Tillinghast,* 287 U. S. —) unless, perhaps, the language of the act is unambiguous and the regulation clearly inconsistent with it. Compare *Louisville & N. R. Co.* v. *United States,* 282 U. S. 740, 757-8. The petitioner insists that the statute needs no interpretation and its plain mandate should be enforced. But on examination the proper application of the section is not so clear as is claimed.

The regulations of the Treasury under all the Revenue Acts since 1916 have required taxpayers to report on the cash or accrual basis, depending on which method was pursued in their accounting.[9] Since the adoption of the Revenue Act of 1921 the requirement has been statutory. It is settled beyond cavil that taxpayers other than insurance companies may not accrue receipts and treat expenditures on a cash basis, or vice versa. Nor may they accrue a portion of income and deal with the remainder on a cash basis, nor take deductions partly on one and partly on the other basis. Congress we think did not intend to make an exception of insurance companies. If they are not allowed to account on an accrual basis for interest owed them there is no reason for permitting them to treat interest owed by them on any different basis. The very paragraph (8) on which petitioner relies as defining interest credited but not paid, by the use of the word "accrued", recognizes that insurance companies may have indebtedness of other sorts, such as that arising from borrowings to carry securities. Since the company is required to treat interest received on

[8]See note 3, *supra.*

[9]Regulations 33 (1918 Ed.), Arts. 126, 180; Regulations 45, Arts. 23, 1533.

a cash basis, it ought not have the privilege of accruing interest owed. That privilege must be accorded, if petitioner is right. We think the result would be unreasonable and is not intended by the act.

We are referred to a regulation which provides: "Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession".[10] It is argued that the regulation requires the policyholder to report interest credited to him as received in the year of credit. The conclusion drawn is that if the credit is income to the insured it must constitute a "constructive payment" by the company. In this view the transaction is said to come within the term "paid" and we may disregard the word "accrued." This regulation has, however, not been applied in any case where income has been credited to another by a taxpayer employing the cash receipts and disbursements method of accounting; and specifically it has not been invoked to require policyholders to report as income the dividends or interest credited to them in cases such as this. No tax is demanded of them until actual receipt of the money. The constructive payment theory is, we think, untenable.

We conclude Congress did not intend by the use of the word "accrued" in § 245 (a) (8) to permit the deduction of interest on policy dividends credited but not paid during the taxable year.

The judgment of the Court of Claims is affirmed.

So ordered.

A true copy.

Test:

Clerk, Supreme Court, U. S.

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[10]Regulations 69, Art. 51.